JOINT
BUDGET
COMMITTEE

# STAFF BUDGET BRIEFING
# FY 2019-20

# CAPITAL CONSTRUCTION
(Excludes Information Technology Projects)

JBC WORKING DOCUMENT - SUBJECT TO CHANGE
STAFF RECOMMENDATION DOES NOT REPRESENT COMMITTEE DECISION

PREPARED BY:
ALFREDO KEMM, JBC STAFF
DECEMBER 19, 2018

JOINT BUDGET COMMITTEE STAFF
200 E. 14TH AVENUE, 3RD FLOOR • DENVER • COLORADO • 80203
TELEPHONE: (303) 866-2061 • TDD: (303) 866-3472
*https://leg.colorado.gov/agencies/joint-budget-committee*

# CONTENTS

# CAPITAL CONSTRUCTION

## CAPITAL CONSTRUCTION OVERVIEW

The capital construction section of the Long Bill includes appropriations to state departments and higher education institutions for capital construction and controlled maintenance projects.

- Capital construction is defined in Section 24-30-1301 (2), C.R.S., and includes purchase of land, construction or demolition of buildings or other physical facilities, site improvement or development, initial purchase and installation of related equipment, and architectural and engineering services for capital projects. House Bill 14-1395, *Information Technology Budget Requests*, removed information technology from the definition of capital asset and removed references to information technology previously included in capital construction. House Bill 15-1266, *Information Technology Budget Request Process*, created the Information Technology Capital Account in the Capital Construction Fund for the purpose of funding information technology projects in the capital construction budget from the Capital Construction Fund while keeping such funding distinct.

- Controlled maintenance is defined in Section 24-30-1301 (4), C.R.S., and includes corrective repairs or replacement for existing real property "when such work is not funded in an agency's or state institution of higher education's operating budget." Pursuant to Section 23-1-106 (10.2), C.R.S., (added in H.B. 12-1318 and amended in S.B. 17-267) higher education academic facilities, even if constructed using solely cash funds for building constructed prior to July 1, 2018, are also eligible for state controlled maintenance funding.

- Capital renewal is defined in Section 24-30-1301 (3), C.R.S., and includes a controlled maintenance project or multiple controlled maintenance projects with costs exceeding $2.0 million for corrective repairs or replacement that is more cost effective than smaller individual controlled maintenance projects. Although capital renewal projects are large or bundled controlled maintenance projects, they are submitted and prioritized as capital construction requests for new projects rather than included in the controlled maintenance section of the capital construction budget.

Some key differences between capital construction and operating budget appropriations:

- Pursuant to Section 24-37-304 (c.3), C.R.S., the executive request is first submitted to the Capital Development Committee (CDC). Pursuant to Section 2-3-1304 and 1305, C.R.S., the CDC is responsible for submitting a written report with its recommendations to the JBC. Pursuant to Section 2-3-203 (b.1), C.R.S., the JBC is responsible for making capital construction appropriation recommendations. However, statute requires that if the JBC wishes to prioritize capital projects differently from the CDC, it must meet with the CDC prior to making such recommendations.

- Senate Joint Resolution 14-039 added guidelines and threshold amounts for the categorization of operating, capital, and IT budget requests. Joint rule 45 was added to legislative rules rather

than statute to provide greater flexibility for revising guidelines and threshold amounts for categorizing budget requests. Joint rule 45 defines operating, capital, and IT budget requests and specifies that these categories of budget request are reviewed by the JBC, CDC, and the Joint Technology Committee (JTC), respectively. It also establishes a referral process for requests that may be more appropriately reviewed by another committee.

- The majority of capital construction funding in the Long Bill originates as General Fund, transferred into the Capital Construction Fund, from which Long Bill appropriations for capital projects are made.

- Capital construction appropriations become available upon enactment of the Long Bill. If a project is initiated within the fiscal year through the encumbrance of spending authority, the appropriation remains available for a period of three years for completion of the project. The three-year appropriation is authorized in the head notes of the capital construction section of the Long Bill. Because a supplemental appropriation amends the original Long Bill appropriation, supplemental appropriations or other non-monetary adjustments to a project in following years do not extend the three-year appropriation. However, H.B. 18-1371, *Capital Construction Budget Items*, codified head notes in statute and specified that spending authority is automatically extended for three years in any supplemental appropriation.

- Although controlled maintenance projects receive line-item appropriations, pursuant to Section 24-30-1303.7, C.R.S., the Executive Director of the Department of Personnel, whose authority is typically delegated to the State Architect, has authority to transfer funds from one controlled maintenance project to another, when the actual cost of a project exceeds the amount appropriated or when an emergency need arises. Pursuant to Section 24-75-302 (3.2), C.R.S., the State Architect is annually appropriated an amount in the Emergency Controlled Maintenance Account in the Capital Construction Fund. Except for $3.0 million appropriated in FY 2017-18, $2.0 million is generally appropriated annually, while reporting shows $2.5 to $3.0 million per year spent on emergencies based on controlled maintenance spending authority.

Recent significant pieces of legislation related to the Capital Construction budget and funding processes include:

- House Bill 18-1374, *Controlled Maintenance Financed Acquired Property*, eliminates the eligibility of buildings financed through lease-purchase agreements, such as certificates of participation (COPs), to receive future state funding for controlled maintenance. The bill requires any future legislation authorizing the issuance of COPs to acquire, construct, or renovate state buildings to include a requirement that a state agency or institution of higher education present a plan for funding future controlled maintenance to the Capital Development Committee. The plan must be presented the December or January before the 16th year after the acquisition or substantial completion of a project financed through a lease-purchase agreement. The plan should assess the controlled maintenance needs of the facility for the next 25 years and may include a request for an additional lease-purchase agreement or a request for state funding. An approved plan must be enacted through a bill, other than the Long Bill or a supplemental bill, unless the plan is from a higher education institution to pay for controlled maintenance from cash funds.

- Senate Bill 17-267, *Sustainability of Rural Colorado*, requires the State to collateralize state buildings through the use of lease purchase agreements in increments of up to $500.0 million per year beginning in FY 2018-19 for four years (up to $2.0 billion in total). The first $120 million from FY 2018-19 proceeds is statutorily allocated for controlled maintenance ($113.9 million) and capital construction ($6.1 million). The balance of the proceeds (up to $1.82 billion) are allocated for highway construction.

- Section 23-1-106 (10.2)(a)(III), C.R.S., also added in S.B. 17-267, specifies that academic buildings acquired or constructed solely from institutional cash funds after July 1, 2018, are not eligible for state controlled maintenance funding. Prior to this provision and date, all academic buildings, whether or not funded with state funds, are eligible for state controlled maintenance funding.

- Senate Bill 15-211, *Automatic Funding for Capital Assets*, established in Section 24-30-1310, C.R.S., created a recapitalization *sinking fund* mechanism to route the annual depreciation amount of capital construction projects into the Capital Construction Fund and the Controlled Maintenance Trust Fund. In time, this mechanism is intended to fully fund controlled maintenance and capital renewal annually. However, the mechanism is in effect for capital construction appropriations included in the Long Bill beginning in FY 2015-16 and its impact on funding is dependent on the relative scale of appropriations made for capital construction in current and future years, relative to the existing building inventory.

- Senate Bill 15-270, *Create the Office of State Architect*, codified the Office of the State Architect and created a statewide planning function in the Office. Pursuant to Section 24-30-1311, C.R.S., the statewide planning function provides centralized planning services for state agencies, provides a technical review of capital construction requests from state agencies for project readiness, and, beginning with FY 2017-18 requests, makes recommendations on capital construction and capital renewal project requests made by state agencies for the Office of State Planning and Budgeting (OSPB), pursuant to Section 24-30-1303, (1) (t) (I), C.R.S.

# CAPITAL CONSTRUCTION BUDGET: RECENT APPROPRIATIONS

| FUNDING SOURCE | FY 2016-17 | FY 2017-18 | FY 2018-19 | FY 2019-20 * |
|---|---|---|---|---|
| Capital Construction Fund | $106,344,091 | $72,056,813 | $138,638,766 | $207,620,165 |
| Cash Funds | 85,410,105 | 44,570,072 | 182,778,907 | 46,203,794 |
| Reappropriated Funds | 766,231 | 10,000,000 | 375,000 | 0 |
| Federal Funds | 1,068,766 | 465,265 | 0 | 0 |
| **TOTAL FUNDS** | **$193,589,193** | **$127,092,150** | **$321,792,673** | **$253,823,959** |

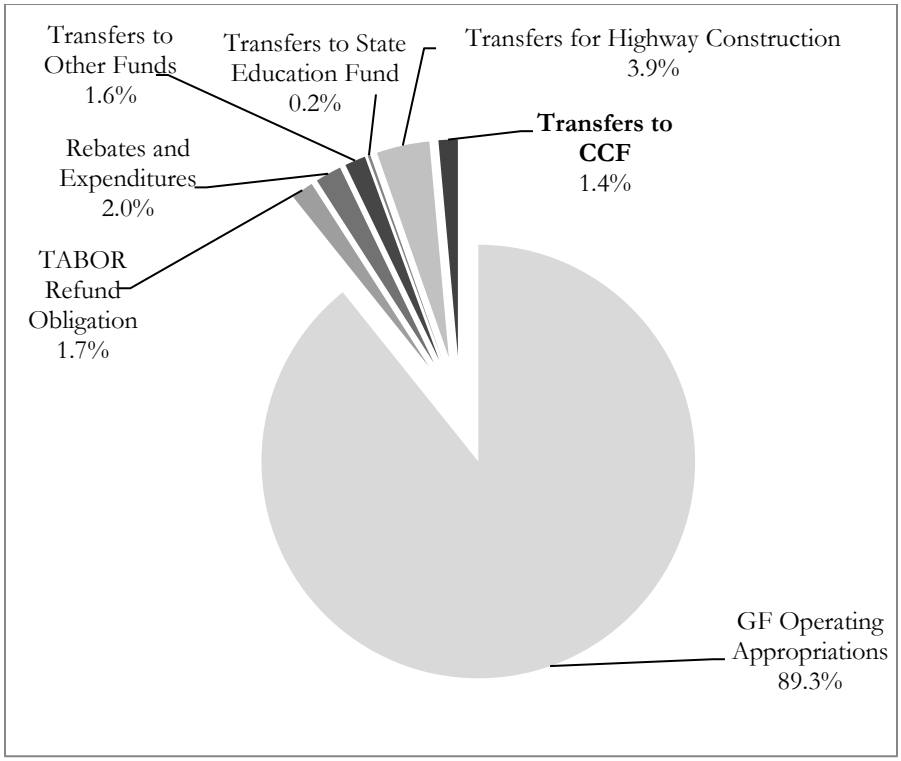
*Requested appropriation.

Table excludes IT Capital appropriation and S.B. 17-267 funding provided in FY 2018-19

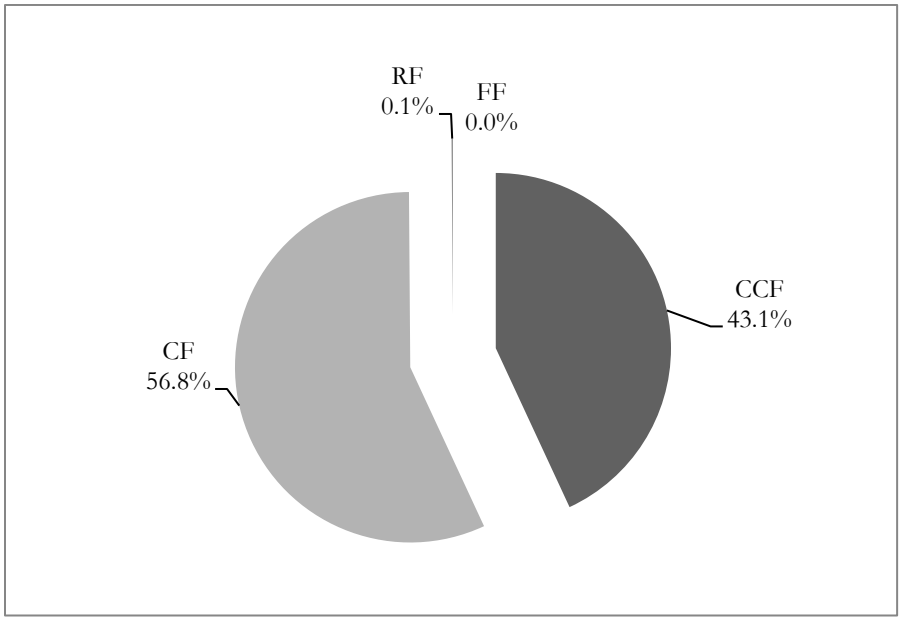
# DEPARTMENT BUDGET: GRAPHIC OVERVIEW

## FY 2018-19 Share of Total Statewide General Fund Expenditures

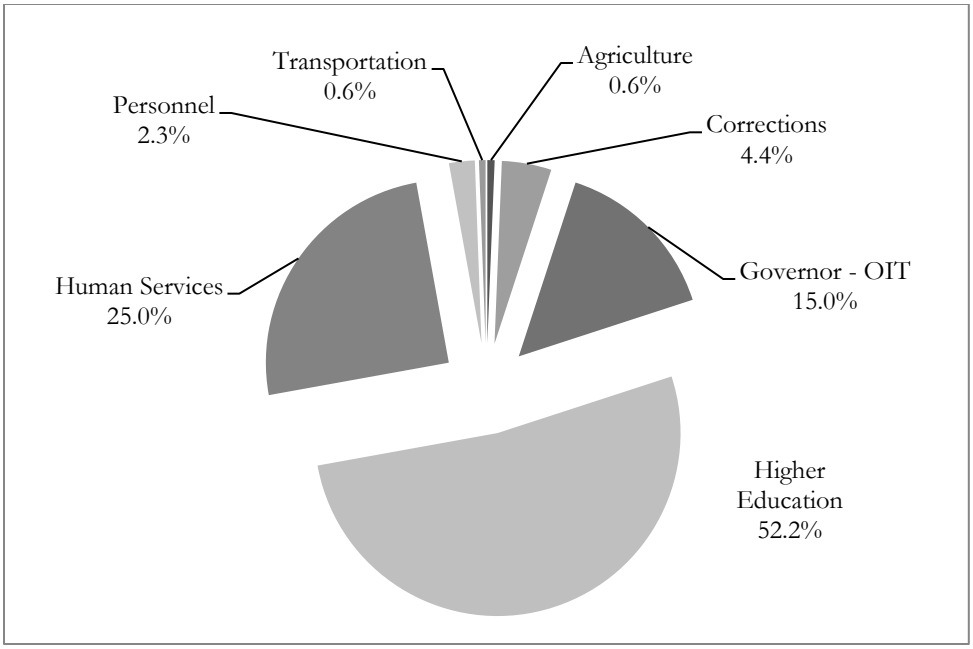
***Source: September 2018 Legislative Council Staff Forecast***



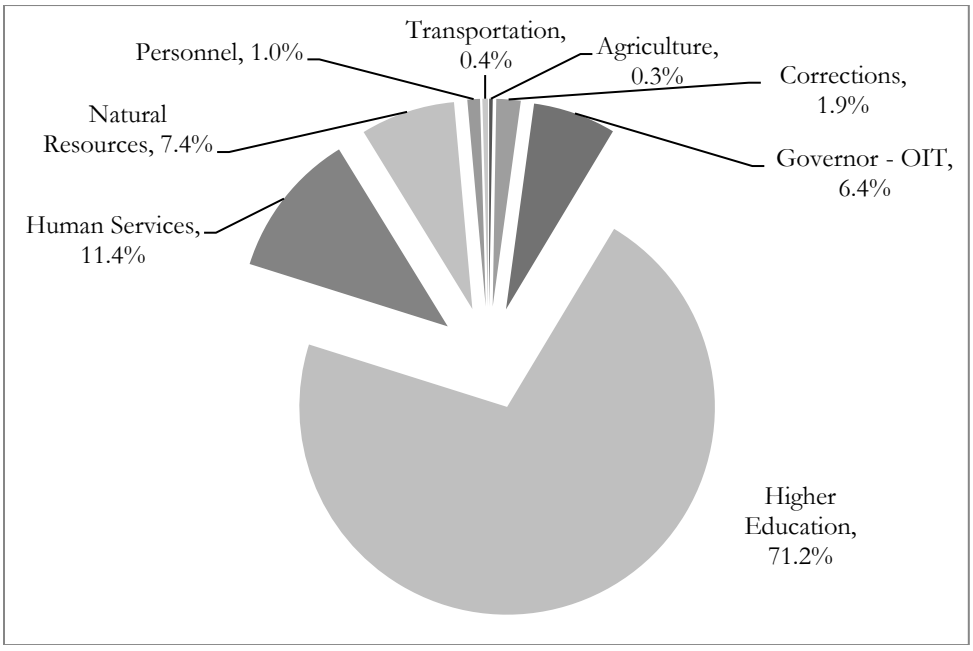

## FY 2018-19 Capital Construction Fund Sources



## FY 2018-19 Distribution of Capital Construction Fund by Department




## FY 2018-19 Distribution of Total Funds by Department



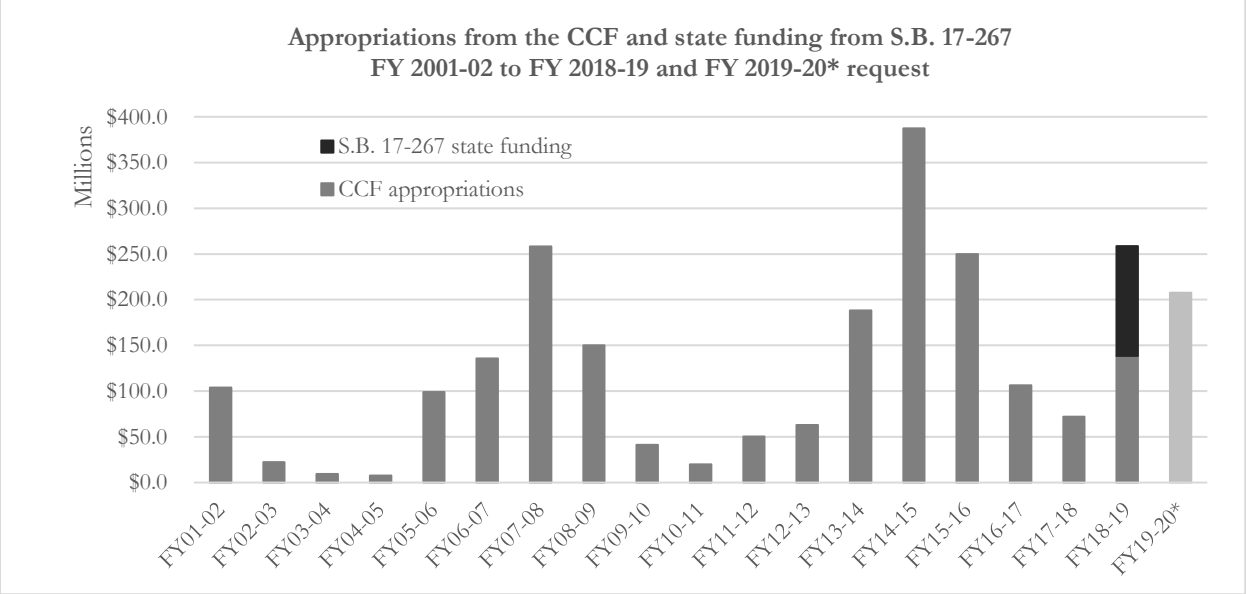
# GENERAL FACTORS DRIVING THE BUDGET

Capital Construction funding for FY 2018-19 consists of 43.1 percent Capital Construction Fund, 56.8 percent cash funds, and 0.1 percent reappropriated funds. The primary budget driver is General Fund revenue available in any given year. Sufficient funding for controlled maintenance and recapitalization is related to the current replacement value of existing building inventory. Additionally, new building construction at institutions of higher education over the last 15 years have generated a substantial commitment for the State.

**REVENUE AVAILABLE FOR CAPITAL CONSTRUCTION**

Transfers to the Capital Construction Fund from the General Fund vary substantially from year-to-year. The amount appropriated for capital construction is based on the recommendations of the Capital Development Committee and on the most recent forecast of revenues available, given constitutional, statutory, and other budget constraints.

The following table outlines appropriations from the Capital Construction Fund since FY 2001-02 through FY 2018-19. The FY 2018-19 bar in the chart includes the appropriation as well as the statutory state funding enacted in S.B. 17-267.




In some years, statutory formulas triggered automatic transfers to the Capital Construction Fund. House Bill 02-1310 provided automatic transfers to the Capital Construction Fund and the Highway Users Tax Fund of excess General Fund revenue. These transfers were replaced in S.B. 09-228 which authorized five years of transfers to the Capital Construction Fund of 0.5 percent of total General Fund revenue for two years followed by 1.0 percent for three years. Transfers were authorized to begin in FY 2012-13, but delayed until a five percent personal income trigger was met. Personal income increased by more than five percent in 2014, triggering the first transfer in FY 2015-16.

However, S.B. 09-228 also provided that a TABOR surplus of between 1.0 and 3.0 percent of General Fund revenue would cut the transfer in half and a TABOR surplus greater than 3.0 percent would

eliminate the transfer entirely. Due to the complexity of the trigger and transfer mechanisms in S.B. 09-228 as they relate to budget projection uncertainty, H.B. 16-1416 set specified transfers of $49.8 million for FY 2015-16 and $52.7 million FY 2016-17. The FY 2017-18 transfer was eliminated and specified transfers of $60.0 million for FY 2018-19 and FY 2019-20 were authorized in S.B. 17-262, which repealed the trigger and transfer provisions for the remaining years of the S.B. 09-228 transfer.

Higher education projects that are funded entirely through cash funds and federal funds are not included in state appropriation bills. Higher education cash funds projects for acquisitions and new construction and projects financed through the revenue bond intercept program that exceed $2.0 million, as well as all other projects (controlled maintenance and capital renewal) that exceed $10.0 million are subject to legislative oversight through the Capital Development Committee, and, when requesting access to financing through the revenue bond intercept program, the Joint Budget Committee.

**PRIORITIZING CONTROLLED MAINTENANCE AND RECAPITALIZATION**

The capital budget process differs from the operating budget process in that budgeting for state agency programs begins from a base which is incrementally adjusted annually. Capital budget decisions are generally prioritized after funding the base operating budget items and are considered discretionary new decision items.

As a budget principle, new construction and real property purchases – *capital expansion* – should be considered as discretionary, new request items in the budget. It is also not unusual, historically, for new construction to be prioritized ahead of controlled maintenance. However, controlled maintenance represents the ongoing upkeep of the existing building inventory. That inventory represents state budget decisions previously made to purchase and own buildings and property. The cost of maintaining existing buildings should be considered as a commitment made at the time the decision to purchase and own a building is made.

Building systems experience both a physical life and an economic life. The physical life is the period until system failure. The economic life is the point at which the annual lifecycle cost of maintaining the existing system exceeds the annual lifecycle cost of a replacement system. Therefore, the discretionary budget decision to spend less on controlled maintenance in a given year does not necessarily save the State money and often increases state facility costs. Instead, not funding the timely replacement of state building systems:

- drives a higher cost in facilities management operating budgets in the current and future years due to increased annual repair, maintenance, and utility costs for deteriorating building systems and inefficient building systems;

- increases future year capital costs due to construction inflation, collateral building system failure, and premature facility deterioration; and

- reduces state agency program effectiveness, particularly when deterioration leads to the unscheduled loss of use of facilities.

*Capital renewal* is defined in Section 24-30-1301 (3), C.R.S., as a controlled maintenance project or group of projects with costs exceeding two million dollars in a fiscal year. *Renovation* projects are

typically identified as capital construction rather than capital renewal because they include improvement in program space and may also include space additions. While new space in a renovation project is properly characterized as "new construction", a renovation project will also include replacement of existing building systems or subsystems that would otherwise require replacement through controlled maintenance. The term *recapitalization* can be used generally to describe controlled maintenance and capital renewal for recapitalizing the existing building stock, and is therefore a good term that can also encompass renovation.

While the terms *repair* and *maintenance* are sometimes used in connection with controlled maintenance projects, ongoing repair and maintenance of systems or subsystems are typically provided by day-to-day facilities management operations and paid for within the annual facility operating cost for a building. Repair and maintenance is an annual process, while recapitalization provides benefits expected to last beyond a year.

Historically, the State Architect's annual report has included the following recommendation:

> *Industry standards continue to emphasize that without an annual Reinvestment Rate (RR) of 3% to 4% of the Current Replacement Value (CRV) of a building inventory, conditions cannot be upgraded or maintained at acceptable levels and will continue to deteriorate (Reference: APPA, American Association of Higher Education Facilities Officers, report titled Capital Renewal and Deferred Maintenance Programs 2009). Concurrently,* ***the Office of the State Architect has recommended as a goal that approximately 1% of the CRV of the State's general funded and academic building inventory be appropriated for Controlled Maintenance on an annual basis*** *to address planned major maintenance and repairs throughout the building inventory* ***and that an additional goal of 1% - 3% of the CRV be appropriated for Capital Renewal/Renovation*** *to address upgrading overall conditions of existing state owned facilities.*

Additionally, the State Architect annually prioritizes controlled maintenance project requests from state agencies and institutions of higher education in three classifications:

- Level 1 are considered critical projects related to life safety or loss of use from equipment or system failure or lack of compliance with codes, standards, and accreditation requirements.

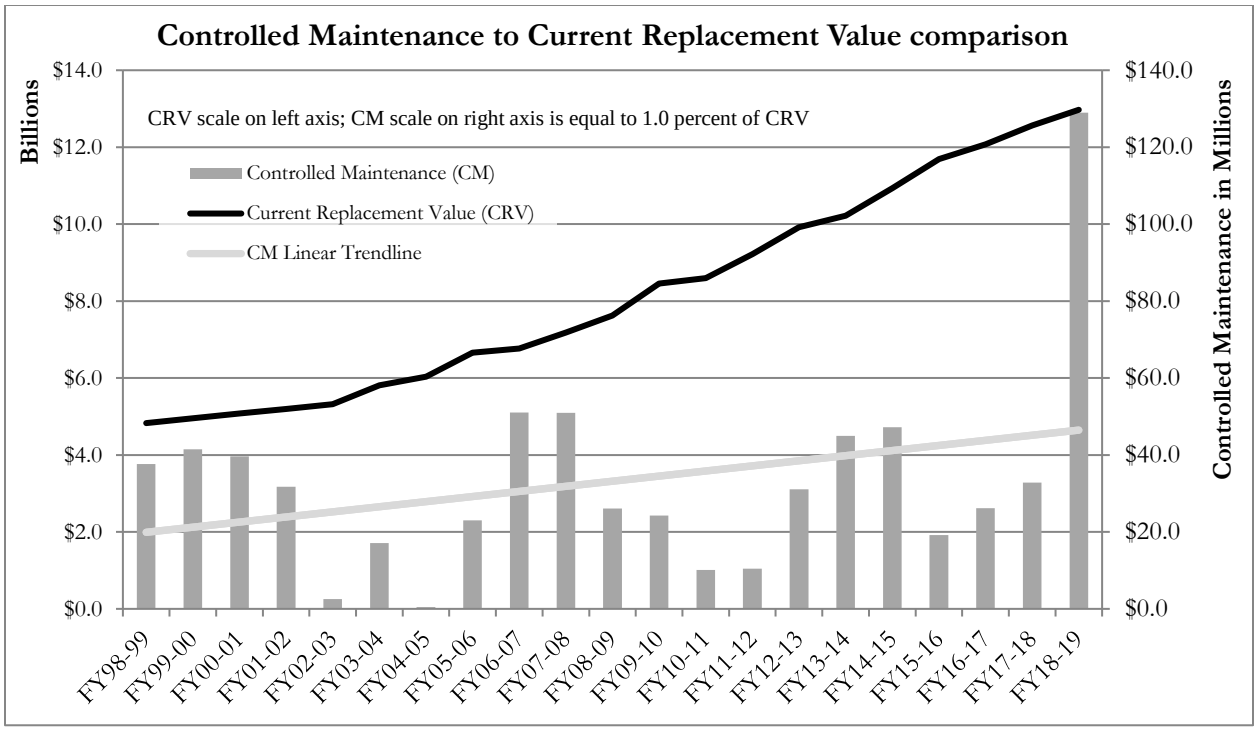
- Level 2 are projects causing operational disruptions, energy inefficiencies, or environmental contamination – predominantly HVAC, electrical, and mechanical systems.

- Level 3 are other building deterioration – typically related to building envelope including roofs, windows, and building surface.

In order to better focus the state's commitment to controlled maintenance and recapitalization, the 2017 capital construction section of the Long Bill was reorganized into four sections:

1. Controlled Maintenance;
2. Capital Renewal and Recapitalization;
3. Capital Expansion; and
4. Information Technology Projects.

Statewide controlled maintenance funding has trended flat since FY 1998-99. The decline compares to the total current replacement value of state buildings, which has increased. The increase reflects growth in total square footage of state buildings along with an increase in value of real property related to inflation and market value. The following chart reflects controlled maintenance (CM) funding compared to current replacement value (CRV).

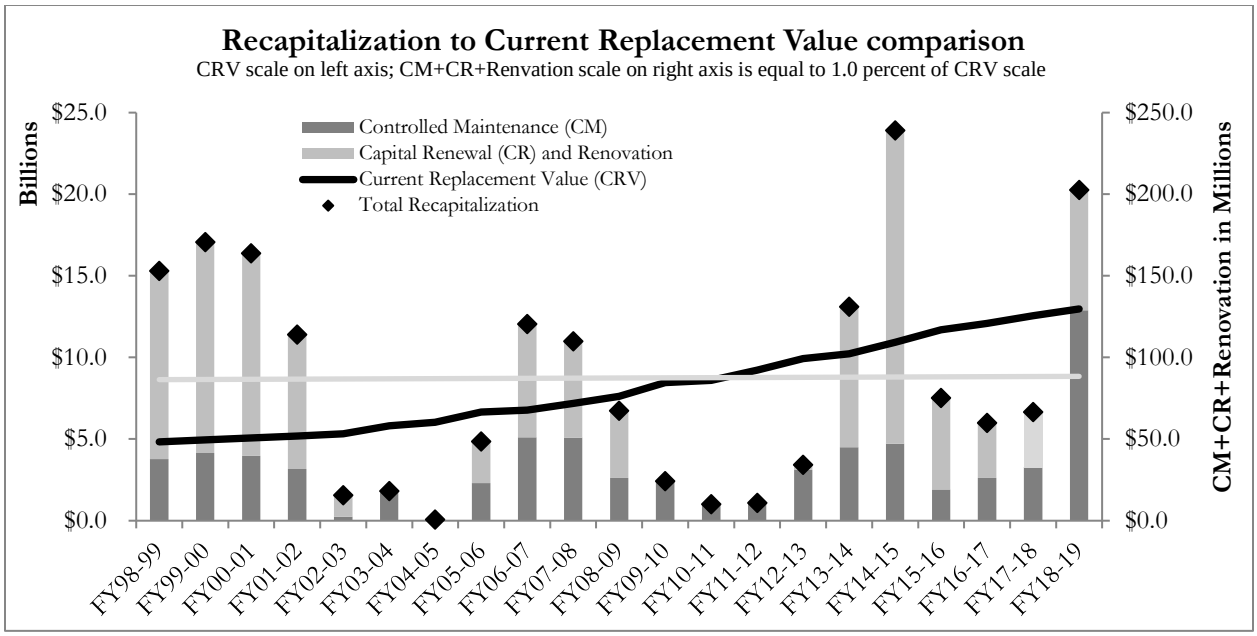



The CRV scale, represented in billions, is shown on the left side of the chart with values reflected in the black line. The CM scale, represented in millions, is shown on the right side of the chart with values reflected in the grey bars. The CM scale is set equal to 1.0 percent of the CRV scale. Controlled maintenance spending in any year that is equal to 1.0 percent of current replacement value would be reflected in the chart as exactly equal to CRV.

In FY 2018-19, total controlled maintenance funding of $129.0 million, which included $15.1 million in Long Bill appropriations and $113.9 million in state funds from S.B. 17-267 collateralization COPs, just equaled 1.0 percent of CRV of $12.97 billion. While the additional funds from S.B. 17-267 collateralization COPs provided a substantial "catch-up" funding boost for controlled maintenance generally, keep in mind that the State Architect's recommended funding for controlled maintenance is 1.0 percent per year. Controlled maintenance funding equal to 1.0 percent of CRV would require a similar effort each year to meet that standard.

CRV increases from just under $5.0 billion to $13.0 billion and, aside from FY 2018-19, the gap between CRV and CM generally widens over time. The CM linear trend line indicates that spending on controlled maintenance is now trending slightly higher due to the funding provided in FY 2018-19. The same chart for the prior year reflected a flat trend line over the prior 20-year period.

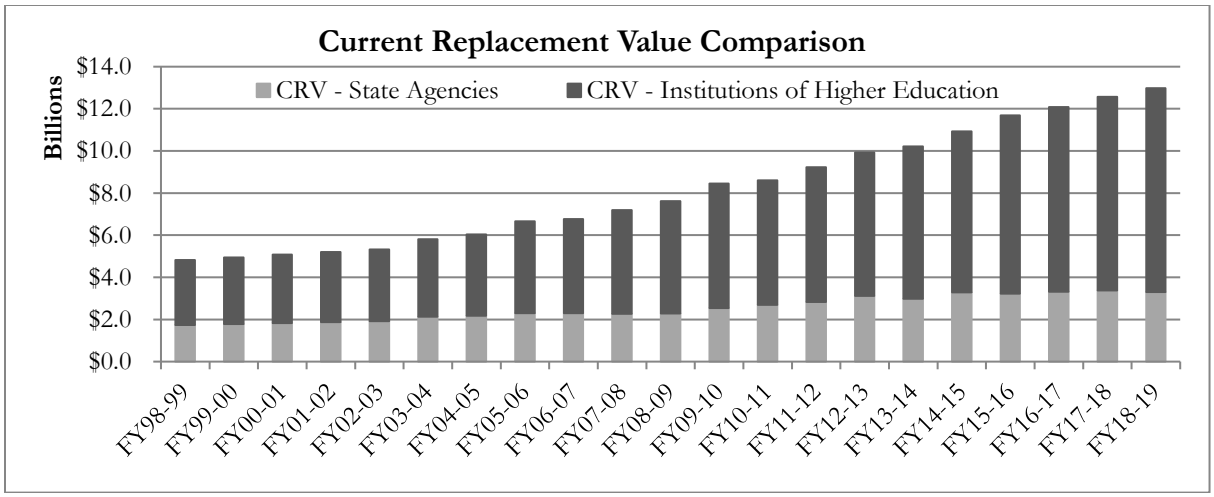
The following chart reflects all recapitalization funding compared to current replacement value.




As the chart illustrates, while funding for recapitalization exceeds 1.0 percent of CRV in nine of the 21 years, the linear trend line is flat. The flat trend line is partially due to the greater funding provided in the early years shown in the chart. Spending on recapitalization in FY 1998-99 through FY 2000-01 was greater than 3.0 percent of CRV. This same chart from last year reflected a downward-sloping trend line over the prior 20-year period. A trend line comparison to the controlled maintenance chart suggests that spending on all recapitalization has trended lower over this period relative to spending on controlled maintenance only.

**COMMITMENTS FOR HIGHER EDUCATION CAPITAL CONSTRUCTION**

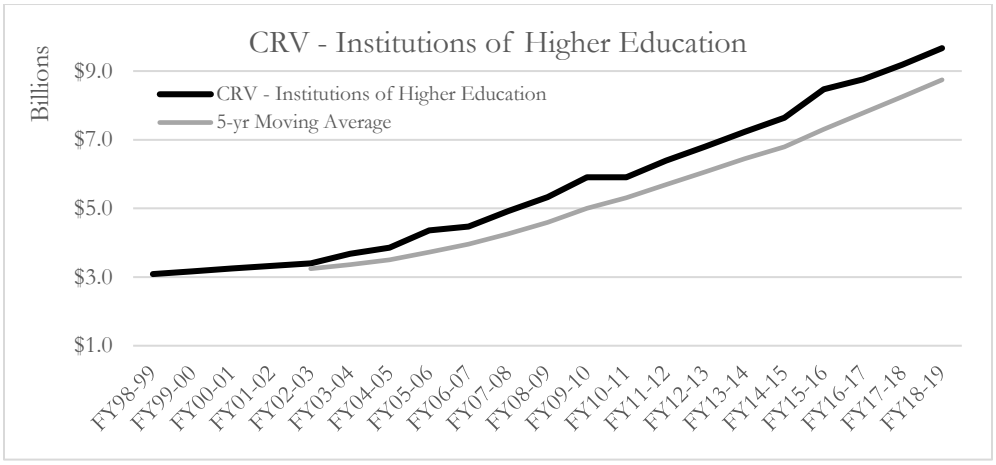
Institutions of Higher Education hold the largest portion of the state's building inventory. The following chart outlines the current replacement value of academic buildings at institutions of higher education and state agencies since FY 1998-99. The higher education total does not include the value of non-academic buildings, which are not provided state-funded controlled maintenance.

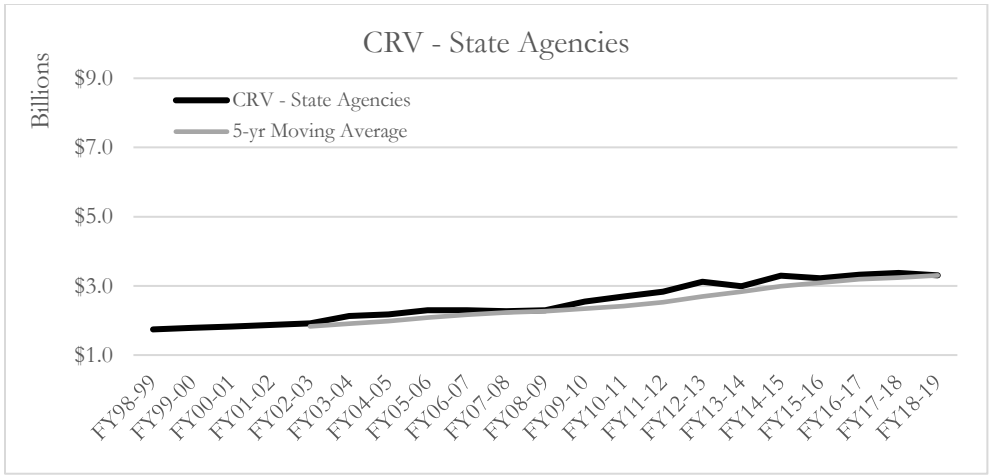


In the current fiscal year, the current replacement value for state agency buildings totaled $3.30 billion, representing a decrease from $3.37 billion in the prior year. The current replacement value for institutions of higher education totaled $9.67 billion, representing an increase from $9.19 billion in the prior year. State agencies and institutions of higher education represent 25.5 percent and 74.5 percent of the $12.97 billion state building inventory, respectively.

In FY 1998-99, current replacement values totaled $1.74 billion and $3.09 billion, respectively, representing 36.1 percent and 63.9 percent of the $4.83 billion total state building inventory.

The state agency building inventory increased 85.1 percent over the 21-year period shown in the chart, a compound average growth rate of 3.0 percent per year, while the institutions of higher education building inventory increased 205.5 percent over that period, a compound average growth rate of 5.5 percent per year. The following charts reflect the change in CRV for each.




Gross square footage increased 23.2 percent and 47.1 percent over that period for state agency and institution of higher education buildings, respectively; a compound average growth rate of 1.0 percent and 1.9 percent per year, respectively.

The State Architect's recommended 1.0 percent funding for controlled maintenance in FY 2018-19 would have totaled $33.0 million for state agency buildings and $96.7 million for institution of higher education buildings. Controlled maintenance appropriations and state funding from collateralization in FY 2018-19 totaled $62.6 million for state agency buildings, representing 189.6 percent of recommended and $66.3 million for institution of higher education buildings representing 68.6 percent of recommended. Other recapitalization (capital renewal and renovation) appropriations from state funds in FY 2018-19 provided an additional $39.8 million and $33.8 million for state agency and institution of higher education buildings, respectively.

Just over $6.5 billion of building inventory for institutions of higher education has been added since FY 1998-99 and $5.8 billion has been added in the last 15 years. The general condition of newer building stock requires less controlled maintenance. However, the State begins funding controlled maintenance for buildings at 15 years. The building inventory added after FY 2004-05 has not yet qualified for controlled maintenance funding, but will qualify beginning in FY 2019-20.

The current and foreseeable state of revenue limits and budget commitments leads to a reduced ability for the State to provide capital construction funding generally. Due to the additional revenue sources available to institutions of higher education for capital expansion, state funding for capital construction for institutions of higher education should be directed more toward controlled maintenance, capital renewal, and recapitalization rather than new construction.

**THE YIN AND YANG OF CAPITAL CONSTRUCTION AND COMMERCIAL LEASED SPACE**

The budget cost of capital construction is entirely and exclusively tied to the cost of housing or providing space for state agency operations. On the basis of that relationship, the alternative solution to providing space for state agency operations is through the annual purchase of commercial leased space in an annual rent payment. While technically not an aspect of capital construction as a budget construct, annual leased space payments in the operating budget represent the alternative or "non-capital construction" solution to providing housing for state agency operations.

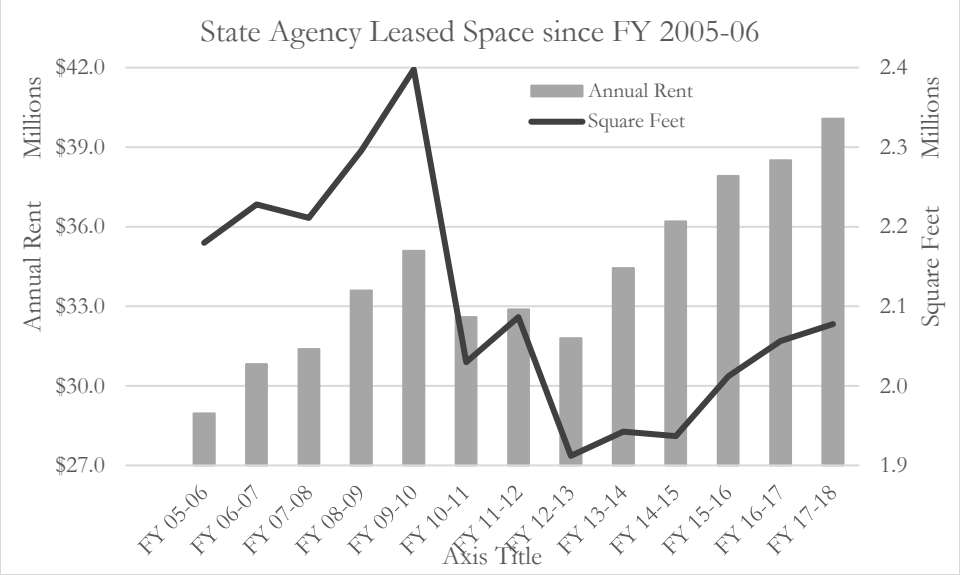
Traditionally, capital construction has been viewed as a one-time, lump-sum payment for a building – a capital asset. The cost appears to be high in the first year and then the cost is free to the State after that; i.e. the cost falls "off-budget". State agency programs which reside in state-funded buildings will appear to have a lower annual operating cost because the cost of real estate appears to be zero in the absence of a budget payment for the capital asset cost.

This traditional manner of identifying capital asset costs is technically inaccurate and not helpful to budget-pricing decisions related to change requests, whether those changes are smaller, incremental space additions or modifications or larger, wholesale building and facility renovations, replacements, or expansion. When annual costs are priced into the budget for a capital asset, requested adjustments to that cost based on needed or desired changes can be directly compared to the program space advantages gained by the State.

Similarly, cash-funded programs housed in state-funded buildings, will necessarily misprice their fees when the cost of housing a program appears to be cost-free, but is in reality subsidized by state funds paid in the capital construction budget. Such cash-funded programs will appear to have a lower cost when leased space or capital construction cost is not included as a cost of the program. When a cash funded program is located in commercial leased space, the cost is readily apparent and, theoretically, is included in the fee calculation.

While commercial leased space is a flexible space-expansion option, particularly for fluctuating or incrementally-expanding state programs, it is also the most expensive state agency space option. A commercial lease must include the private owner's actual facility costs – either construction and financing or depreciation/economic opportunity cost – leasehold improvement costs required by the program for the space, any major maintenance items necessary in the space over the period of the lease, and the landlord's administrative and operating expenses as well as profit. In the commercial leased space option, the full cost of the facility, plus management expenses and profit, is paid in the lease.

The following chart reflects state agency leased space costs statewide since FY 2005-06.




As reflected in the chart, total leased space has decreased to just under 2.1 million square feet from a high of 2.4 million square feet in FY 2009-10. Following the 2008 financial crisis, the State was able to renegotiate relatively affordable, 10-year lease agreements in the downtown Denver area. Some of the decrease reflected in the chart from FY 2009-10 to FY 2012-13, reflects that particular market condition at the time as well as the decrease in leased space square footage also experienced at that time. However, the cost of space has steadily increased since FY 2012-13 to $40.1 million in FY 2017-18 and appears to be increasing, corresponding with the experience of current market conditions. Additionally, since FY 2012-13, square footage appears to be increasing along with rent. While not a factor driving the budget directly, leased space, or the avoidance or replacement of leased space, will likely become a factor to be considered in the capital construction budget in the next five to ten years.

# SUMMARY: FY 2018-19 APPROPRIATION & FY 2019-20 REQUEST

| Priority OSPB | Priority CCHE | | Capital Construction Total Funds | Capital Construction Capital Construction Fund | Capital Construction Cash Funds | Capital Construction Reappropriated Funds | Capital Construction Federal Funds |
|---|---|---|---|---|---|---|---|
| | | FY 2018-19 Appropriation: | | | | | |
| | | FY 2018-19 Long Bill (H.B. 18-1322 – bldg. capital only) | 321,792,673 | 138,638,766 | 182,778,907 | 375,000 | 0 |
| | | **TOTAL** | **$321,792,673** | **$138,638,766** | **$182,778,907** | **$375,000** | **$0** |
| | | | | | | | |
| **OSPB** | **CCHE** | FY 2019-20 Prioritized Requests (state-funded) Requested Appropriation: | | | | | |
| **1** | | Level I Controlled Maintenance (28 items) | 27,963,348 | 27,963,348 | 0 | 0 | 0 |
| **2** | | DHS: DYS Facility Refurbishment | 2,638,927 | 2,638,927 | 0 | 0 | 0 |
| **3** | **1** | HED: UC-Denver CU Anschutz - Center for Personalized Medicine and Behavioral Health | 31,251,986 | 19,846,986 | 11,405,000 | 0 | 0 |
| **4** | **2** | HED: FRCC Larimer Campus Health Care Career Center | 15,623,484 | 11,927,424 | 3,696,060 | 0 | 0 |
| **5** | **3** | HED: CSU Shepardson Building Renov. and Addition | 22,482,700 | 13,482,700 | 9,000,000 | 0 | 0 |
| **6** | **4** | HED: FLC Whalen Gymnasium Expansion and Renovation for Exercise Science | 28,057,892 | 25,252,103 | 2,805,789 | 0 | 0 |
| **7** | | DOC: DRDC and CCF Population Swap | 11,122,534 | 11,122,534 | 0 | 0 | 0 |
| **8** | | DHS: CMHIP Campus Utility Infrastructure Upgrade, ph 1 of 3 (capital renewal) | 9,155,876 | 9,155,876 | 0 | 0 | 0 |
| **9** | | DOC: SCF Steam Condensate Line Repl. (capital renewal) | 6,595,031 | 6,595,031 | 0 | 0 | 0 |
| **10** | | DOC:AVCF Utility Water Lines Repl. (capital renewal) | 7,038,924 | 7,038,924 | 0 | 0 | 0 |
| **11** | **12** | HED: UNC Boiler #3 Replacement (capital renewal) | 3,679,012 | 3,634,012 | 45,000 | 0 | 0 |
| **12** | | DMVA: GJ Veterans Memorial Cemetery Columbarium and Upgrade Steam Filter System | 2,667,390 | 2,667,390 | 0 | 0 | 0 |
| **13** | | Level II Controlled Maintenance, part 1 (28 items) | 26,598,340 | 26,598,340 | 0 | 0 | 0 |
| **14** | | DHS: CMHIFL F2 and F3 Cottage Renovation | 17,835,851 | 17,835,851 | 0 | 0 | 0 |
| **15-17** | | TRE/HED: CSU NWC COP Projects | 0 | 0 | 0 | 0 | 0 |
| **18** | | DHS: Secure Treatment Facility for Restorations | 11,544,347 | 11,544,347 | 0 | 0 | 0 |
| | | **SUBTOTAL - Prioritized Requests** | **$224,255,642** | **$197,303,793** | **$26,951,849** | **$0** | **$0** |
| | | | | | | | |
| | | FY 2019-20 OSPB Prioritized as IT Capital: | | | | | |
| | | GOV-OIT: Microwave Infrastructure Replacement | 10,316,372 | 10,316,372 | 0 | 0 | 0 |
| | | **SUBTOTAL - Additional Prioritized Request** | **$234,572,014** | **$207,620,165** | **$26,951,849** | **$0** | **$0** |
| | | | | | | | |
| | | FY 2019-20 Non-prioritized Requests (100% cash-funded) Requested Appropriation: | | | | | |
| | | DHS: VCLC Homelake Rotunda/Workshop Renovations | 197,573 | 0 | 197,573 | 0 | 0 |
| | | DHS: VCLC Fitzsimons Upgrades | 199,635 | 0 | 199,635 | 0 | 0 |
| | | DNR: Infrastructure and Facilities | 2,158,090 | 0 | 2,158,090 | 0 | 0 |
| | | DNR: Property Acquisitions | 11,000,000 | 0 | 11,000,000 | 0 | 0 |
| | | DHS: Department-wide Facility Master Plan | 1,101,159 | 0 | 1,101,159 | 0 | 0 |
| | | DHS: DRCO Depreciation Fund Capital Improvements | 757,405 | 0 | 757,405 | 0 | 0 |
| | | HistCO: Regional Property Preservation Projects | 700,000 | 0 | 700,000 | 0 | 0 |
| | | **SUBTOTAL - Non-prioritized Requests** | **$16,113,862** | **$0** | **$16,113,862** | **$0** | **$0** |
| | | | | | | | |
| | | **TOTAL** | **$250,685,876** | **$207,620,165** | **$43,065,711** | **$0** | **$0** |
| | | | | | | | |
| | | **INCREASE/(DECREASE)** | ($71,106,797) | $68,981,399 | ($139,713,196) | ($375,000) | $0 |
| | | Percentage Change | (22.1%) | 49.8% | (76.4%) | (100.0%) | n/a |

### OSPB Estimated General Fund Transfer

Based on their priority list, including $197.3 million for prioritized capital construction projects and $23.2 million for Information Technology Projects, OSPB estimates the need for a transfer of $220.5 million from the General Fund to the Capital Construction Fund.

### Staff Observations

The OSPB budget request does not include $500,000 for CDOT Transportation Projects that is traditionally included in the capital construction budget. Additionally, the General Fund transfer estimate does not identify an adjustment for the specified $60.0 million General Fund transfer to the Capital Construction Fund included in S.B. 17-262. However, it is likely that OSPB is reflecting the total transfer necessary regardless of transfer type.

The OSPB budget request has included the Colorado State University (CSU), National Western Campus (NWC), COP-funded projects as priorities 15 through 17 at zero dollars in the request. Statute specifies budget notification for the initiation of these projects. Staff believes all project notifications were provided in prior year budget requests; nevertheless, they have been included again in this year's prioritization list.

Funding for CSU NWC COP payments is provided from the National Western Center Trust Fund (NWCTF) created in Section 23-31-902 (2), C.R.S. Beginning July 1, 2019, for up to 20 years, funds for all COP payments up to $20.0 million are to be transferred into the NWCTF. Funding is from General Fund formerly set aside for COP payments for the Colorado State Penitentiary II (CSP II) project, which were concluded in FY 2018-19. The remainder of the $20.0 million may be transferred upon request of the Capital Development Committee to the Capitol Complex Master Plan Implementation Fund to fund projects related to the Capitol Complex Master Plan.

It is staff's understanding that these COP payments have been included in the Department of Higher Education operating budget request. Traditionally, all COP payments were included in the capital budget. In recent years, budget practice has changed so that COP payments are included in the capital budget only while a project is under construction. Once construction is complete, the COP payment is moved to the operating budget. It is likely that these CSU NWC COP payments will be included in the capital budget in FY 2019-20 and for the period until these projects have completed construction and are in use.

### OSPB Prioritized Not Recommended for Funding and CCHE Prioritized

The following table includes additional projects prioritized by OSPB and CCHE.

| Capital Construction | | | | | |
|---|---|---|---|---|---|
| Priority | | | Total Funds | Capital Construction Fund | Cash Funds |
| OSPB | CCHE | FY 2019-20 OSPB Prioritized but Not Recommended for Funding: | | | |
| 19 | | DHS: CMHIFL Campus Utility Infrastructure Upgrade (capital renewal) | 10,493,712 | 10,493,712 | 0 |
| 20 | 12 | HED: AHEC Critical Infrastructure Heating and Hot Water System Replacement (capital renewal) | 18,688,778 | 18,488,778 | 200,000 |
| 21 | | DHS: CMHI Suicide Mitigation Continuation | 11,061,491 | 11,061,491 | 0 |
| 22 | | DOC: AVCF Electronic Security Sys Repl. (cap renewal) | 2,745,296 | 2,745,296 | 0 |

| Capital Construction | | | | | |
|---|---|---|---|---|---|
| Priority | | | Total Funds | Capital Construction Fund | Cash Funds |
| OSPB | CCHE | FY 2019-20 OSPB Prioritized but Not Recommended for Funding: | | | |
| 23 | | HistCO: Grant-Humphreys Mansion Exterior Repairs (capital renewal) | 3,293,581 | 3,293,581 | 0 |
| 24 | | Level II Controlled Maintenance (remainder) | 18,387,145 | 18,387,145 | 0 |
| 25 | | Level III Controlled Maintenance | 22,800,000 | 22,800,000 | 0 |
| 26 | | DOC: SCF Renov. Kitchen-Food Bldg. (capital renewal) | 31,966,193 | 31,966,193 | 0 |
| 27 | 5 | HED: WSCU Mountain Bowl Events Complex | 6,077,784 | 4,037,784 | 2,040,000 |
| 28 | 6 | HED: UCD Engineering and Physical Sci. Bldg. Renov. | 18,670,391 | 4,802,793 | 13,867,598 |
| 29 | 7 | HED: CCA New Diesel Education and Supp. Svcs. Bldg. | 8,411,262 | 5,911,262 | 2,500,000 |
| 30 | 8 | HED: ACC Health Programs Integration Renovation | 11,152,093 | 8,364,000 | 2,788,093 |
| 31 | 9 | HED: UCB Hellems Building Renovation | 7,679,700 | 3,225,474 | 4,454,226 |
| 32 | 10 | HED: CMU PA/PT/OT Center | 10,768,131 | 8,937,548 | 1,830,583 |
| 33 | 10 | HED: CSM Subsurface Frontiers Building | 11,225,759 | 1,856,741 | 9,369,018 |
| 34 | 14 | HED: CCD Boulder Creek | 24,524,696 | 20,600,745 | 3,923,951 |
| 35 | 15 | HED: CMU Kinesiology Renovation and Expansion | 22,853,608 | 20,796,784 | 2,056,824 |
| 36 | 16 | HED: CSM Arthur Lakes Library Renovation | 13,000,000 | 10,000,000 | 3,000,000 |
| 37 | 17 | HED: UCB Guggenheim Capital Renovation | 2,599,052 | 1,039,621 | 1,559,431 |
| 38 | 17 | HED: FLC Whalen Gymnasium Expansion and Renov. | 2,024,775 | 1,619,820 | 404,955 |
| 39 | 19 | HED: UCCS Renovation of Existing Engineering Bldg. | 14,056,086 | 8,056,086 | 6,000,000 |
| 40 | 20 | HED: CU Anschutz College of Nursing and Student Support Services Renovation | 17,626,512 | 8,813,206 | 8,813,306 |
| 41 | 21 | HED: CMU Electrical and Computer Engineering Bldg. | 19,731,698 | 16,377,308 | 3,354,390 |
| 42 | 22 | HED: CSU Anatomy Zoology East Wing Revitalization | 16,717,169 | 16,717,169 | 0 |
| 43 | 22 | HED: UNC Gray Hall Mech Systems Repl. (cap renewal) | 3,419,167 | 3,419,167 | 0 |
| 44 | 24 | HED: CSU-P Technology Building Renov. and Addition | 16,583,000 | 16,417,170 | 165,830 |
| 45 | 25 | HED: CMU Student Parking Garage | 25,453,594 | 23,162,770 | 2,290,824 |
| 46 | 25 | HED: CMU Performing Arts Expansion and Renovation | 9,477,180 | 8,624,233 | 852,947 |
| 47 | 27 | HED: LCC Library/LRC Renov-BW Bldg. (cap renewal) | 1,922,205 | 1,872,205 | 50,000 |
| 48 | 28 | HED: CSU Chem. B and C Wing Revit. (capital renewal) | 26,399,351 | 26,399,351 | 0 |
| 49 | 29 | HED: OJC Computer Lab and Emerg. Notif. Upgrades | 550,000 | 475,000 | 75,000 |
| 50 | 30 | HED: UNC Next Generation Cyber Secure Network | 1,488,706 | 1,488,706 | 0 |
| 51 | 31 | HED: OJC Humanities Center Asbestos Abatement and Seating Replacement - phase 1 of 2 (capital renewal) | 782,300 | 782,300 | 0 |
| 52 | 32 | HED: CCA Improving Student Access to Technology | 527,845 | 475,061 | 52,784 |
| 53 | 33 | HED: LCC Modernize Campus Technology | 585,422 | 570,422 | 15,000 |
| 54 | 34 | HED: TSJC Berg Fourth Floor Remodel (capital renewal) | 1,691,355 | 1,691,355 | 0 |
| 55 | 35 | HED: CCCS-L CCA North Quad (901) Building | 1,911,970 | 1,911,970 | 0 |
| 56 | 36 | HED: TSJC Technology Infrastructure | 636,846 | 636,846 | 0 |
| 57 | 37 | HED: PPCC Campus Emergency Notif. and Power | 524,865 | 524,865 | 0 |
| 58 | 38 | HED: CSU-P Communications System Upgrade | 4,290,130 | 4,290,130 | 0 |
| 59 | 39 | HED: CSU Network Refresh and Upgrade - phase 1 of 3 | 498,000 | 498,000 | 0 |
| 60 | 40 | HED: NJC Consolidation of Physical Plant Spaces | 450,000 | 450,000 | 0 |
| 61 | | PER: Capitol Complex 1881 Pierce Renov. Parking Lots | 5,195,202 | 5,195,202 | 0 |
| 62 | | CDOT: Eisenhower Johnson Memorial Tunnels (EJMT) Electrical System | 1,000,000 | 1,000,000 | 0 |
| | | **SUBTOTAL - OSPB Prioritized but Not Recommended for Funding** | **$429,942,050** | **$360,277,290** | **$69,664,760** |
| | | **SUBTOTAL - CCHE All Prioritized** | **$424,094,504** | **$327,477,895** | **$96,616,609** |
| | | **SUBTOTAL - CCHE Prioritized Top 20** | **$290,453,701** | **$200,693,867** | **$89,759,834** |

# ISSUE 1: THE CMTF AND DEPRECIATION-LEASE EQUIVALENT PAYMENTS

Section 24-30-1310, C.R.S., enacted in S.B. 15-211, requires depreciation-lease equivalent payments from the General Fund to the Capital Construction Fund and the Controlled Maintenance Trust Fund (CMTF) for state-funded capital construction projects. The CMTF was established to provide a consistent source of revenue to fund controlled maintenance from interest earnings. However, the CMTF is also a designated state emergency reserve which allows the Governor to draw from the principal for emergency declarations. Primarily due to draws for emergencies and due to the low interest rate environment since 2008, the reduced principal in the CMTF has not generated interest earnings to meaningfully fund controlled maintenance. Additionally, state agencies may be improperly expensing rather than depreciating capital construction expenditures, sidestepping the depreciation-lease equivalent payment mechanism intended to create a closed loop for capital construction funding.

## SUMMARY:

- Senate Bill 15-211 requires depreciation-lease equivalent payments from the General Fund to the Capital Construction Fund and the Controlled Maintenance Trust Fund for state-funded capital construction projects funded in the capital construction section of the Long Bill on or after FY 2015-16.

- The depreciation-lease equivalent payment functions as a *sinking fund* transfer mechanism for capital construction funding with the purpose of retaining or maintaining dollars invested in capital construction through transfers equal to depreciation; i.e. for every dollar spent on capital construction assets, upon depreciation of those capital assets, an equivalent amount in cash would be returned to capital construction-related funds through this mechanism.

- Statute specifies that 1.0 percent of the project cost be credited to the Controlled Maintenance Trust Fund from the depreciation-lease equivalent payment each year. For a 40-year depreciation schedule, equal to 2.5 percent depreciation per year, the 1.0 percent formula credited to the Controlled Maintenance Trust Fund equals 40.0 percent of the depreciation-lease equivalent payment; the remaining 60.0 percent is deposited in the Capital Construction Fund.

- Over the last 10 years, with the exception of a single transfer of $1.0 million in FY 2016-17, the Controlled Maintenance Trust Fund has not provided resources for its primary purpose of funding controlled maintenance from interest earnings.

- Depreciation subject to S.B. 15-211 was recorded for the first time and included in the budget in FY 2018-19, for $175,060 in the Department of Higher Education and for $89,345 in the Department of Public Health and Environment.

- In the prior year, at least one state agency has improperly expensed rather than depreciated capital construction expenditures, sidestepping the depreciation-lease equivalent payment budget mechanism that is structured in statute to be based on depreciation.

## DISCUSSION:

### AN OVERVIEW OF S.B. 15-211

In 2015, staff recommended and the Committee pursued legislation to create a transfer mechanism based on depreciation for capital construction appropriations in the Long Bill beginning in the FY 2015-16 budget.

The *annual depreciation-lease equivalent payment* is a transfer from the General Fund intended to function as a *sinking fund* transfer mechanism for all current and future capital construction purchases. A sinking fund periodically sets aside money for the replacement of a depleting asset.

State government depreciation is recorded for the purpose of collecting construction and capital asset costs from the federal government for federally supported programs housed in state buildings. Such depreciation is included in the statewide indirect cost assessment plan developed by the State Controller annually. Indirect cost recoveries collected by state agencies as set in the statewide plan are then used to offset General Fund in each department operating budget, reducing the state's expenditure of General Fund by an amount equal to the annual statewide indirect cost recovery. Through this cycle, the depreciation of capital assets – captured in the indirect cost plan – has historically been routed to the operating budget.

The mechanism in S.B. 15-211 creates a *closed-loop* for capital construction dollars. When a capital construction project is funded, state funds are spent for that purpose, and the state funds purchase a capital asset equal to the same amount. As the capital project is depreciated on the state's accounting books, the capital asset value decreases by the amount of depreciation. The transfer mechanism in S.B. 15-211 returns the cash amount of the book depreciation to the state's capital construction funds. In this way, when a dollar is spent on capital construction, it is retained in the state's capital assets accounts through this transfer. As asset book values decrease by the depreciation amount, capital construction cash assets increase by the same amount, which are then used to pay for current recapitalization needs generally and the cycle repeats indefinitely for a new or additional dollar added to the state's capital assets stock.

### SECTION 24-30-1310, C.R.S.

Section 24-30-1310 (2)(b) and (2)(c)(II), C.R.S., states:

> *(2) For every appropriation in the capital construction section of the 2015-16 annual general appropriation act and every appropriation in the capital construction section of each annual general appropriation act thereafter, not including appropriations for information technology projects, additional funding must be set aside as follows:*
>
> *(b) If the funding source for the appropriation is from the general fund, the capital construction fund, or the controlled maintenance trust fund, the general assembly shall include an annual depreciation-lease equivalent payment line item payable from the general fund in the operating section of the annual general appropriation act for each state agency, including the department of higher education. On June 30 the state controller shall credit the annual depreciation-lease equivalent payment line item to the capital construction fund; except that, of such payment, an amount equal to one percent of the project cost will be deducted from the payment and credited to the principal of the controlled maintenance trust fund.*

*(c) If the funding source for the appropriation is a financing arrangement, including a lease-purchase agreement allowed pursuant to section 24-82-802, and the source of the funding for the financing payment is:*

*(II) From the general fund, the capital construction fund, or the controlled maintenance trust fund, then the general assembly shall include an annual controlled maintenance line item payable from the general fund in the operating section of the annual general appropriation act for each state agency, including the department of higher education, equal to one percent of the project cost, as calculated by the state agency of the state institution of higher education, which calculation the state institution of higher education shall report to the department of higher education. On June 30 the state controller shall credit such amount to the controlled maintenance trust fund.*

Section 24-30-1310 (2)(b), C.R.S., specifies that 1.0 percent of the project cost be credited to the Controlled Maintenance Trust Fund from the depreciation-equivalent payment each year. Similarly, Section 24-30-1310 (2)(c)(II), C.R.S., specifies that 1.0 percent of the project cost be credited to the Controlled Maintenance Trust Fund for an annual controlled maintenance line item for COP-financed projects. For a 40-year depreciation schedule, equal to 2.5 percent depreciation per year, the 1.0 percent formula credited to the Controlled Maintenance Trust Fund equals 40.0 percent of the depreciation-equivalent payment; the remaining 60.0 percent is deposited in the Capital Construction Fund.

**THE CURRENT STATE OF THE CONTROLLED MAINTENANCE TRUST FUND**

At the time in 2015, staff had recommended a 60-40 percent split for the purpose of building the principal of the Controlled Maintenance Trust Fund. Staff's thinking was that this might enable the fund to generate sufficient interest for the payment of controlled maintenance for these projects in 15 years, when statute provides that controlled maintenance could first be requested and funded for a building. However, since that time, staff has become convinced that the Controlled Maintenance Trust Fund is not functioning as intended in the legislative declaration creating the fund and likely never will as long as it includes its state emergency reserve designation.

The legislative declaration in Section 24-75-302.5 (1), C.R.S., states:

*(1) In light of the fluctuating amounts of state revenues that have been available for controlled maintenance purposes in the past, the general assembly hereby finds and declares that a stable, predictable, and consistent source of revenues for controlled maintenance projects will better allow the state to fund such projects on a timely basis and avoid higher replacement costs. In order to provide a consistent source of revenues, the general assembly hereby further finds and declares that it is appropriate to create a trust fund which will generate an annual amount of interest which will be dedicated to controlled maintenance.*

Section 24-75-302.5 (2), C.R.S., includes "For the 1996-97 fiscal year and fiscal years thereafter, the principal of the trust fund may constitute all or some portion of the state emergency reserve …".

The following table outlines the transfers and appropriations in and out, executive order emergency transfers, and interest earnings and controlled maintenance funding for the Controlled Maintenance Trust Fund from 2008 through 2017.

| CONTROLLED MAINTENANCE TRUST FUND - 10-YEAR CASH FLOWS | | | | | | |
|---|---|---|---|---|---|---|
| | FUND OUTFLOWS | | | FUND INFLOWS | | |
| | Executive Orders for Emergencies | Appropriations Funded and Transfers Out | Controlled Maintenance Funded | Appropriations and Transfers In and Reversions | Interest Earnings | Balance |
| Balance July 1, 2008 | | | | | | $1,272,470 |
| | | | | | | |
| FY 2007-08 1331s | | (744,208) | | | | |
| Interest Earnings | | | | | 46,821 | |
| HB 08-1375 GF appropriation | | | | 6,069,495 | | |
| 28 bills funded from set-aside | | (5,627,966) | | | | |
| Balance July 1, 2009 | | | | | | 1,016,613 |
| | | | | | | |
| Interest Earnings | | | | | 5,359 | |
| SB 09-279 - transfer to GF | | (803,610) | | | | |
| Balance July 1, 2010 | | | | | | 218,362 |
| | | | | | | |
| Interest Earnings | | | | | 4,302 | |
| Balance July 1, 2011 | | | | | | 222,664 |
| | | | | | | |
| Interest Earnings | | | | | 3,038 | |
| Balance July 1, 2012 | | | | | | 225,702 |
| | | | | | | |
| Reversion from AGR | | | | 131,693 | | |
| Interest Earnings | | | | | 21,752 | |
| HB 12-1335 GF appropriation | | | | 13,000,000 | | |
| SB 13-230 GF appropriation | | | | 10,000,000 | | |
| 12 Executive Order transfers | (20,150,000) | | | | | |
| Balance July 1, 2013 | | | | | | 3,229,147 |
| | | | | | | |
| Interest Earnings | | | | | 241,000 | |
| SB 13-230 GF appropriation | | | | 23,000,000 | | |
| SB 13-230 FF CHP Bonus | | | | 25,000,000 | | |
| 6 Executive Order transfers | (50,850,000) | | | | | |
| HB 14-1249 | | | | 78,000,000 | | |
| Balance July 1, 2014 | | | | | | 78,620,147 |
| | | | | | | |
| Interest Earnings | | | | | 724,354 | |
| HB 14-1336 GF appropriation | | | | 20,093,068 | | |
| 47 bills funded from set-aside | | (19,981,804) | | | | |
| SB 14-189 transfer to GF | | (9,672,000) | | | | |
| Balance July 1, 2015 | | | | | | 69,783,765 |
| | | | | | | |
| Interest Earnings | | | | | 660,435 | |
| Interest Correction FY2014-15 | | | | | (8,054) | |
| Balance July 1, 2016 | | | | | | 70,436,146 |
| | | | | | | |
| Interest Earnings | | | | | 656,136 | |
| HB 16-1417 | | | (1,000,000) | | | |
| 4 Executive Order transfers | (20,125,000) | | | | | |
| Balance July 1, 2017 | | | | | | 49,967,282 |
| | | | | | | |
| SB 17-263 GF transfer (FY 2017-18) | | | | 20,000,000 | | |
| Current Estimated Balance | | | | | | $69,967,282 |

| | Fund Outflows | | | Fund Inflows | | |
|---|---|---|---|---|---|---|
| | Executive Orders for Emergencies | Appropriations Funded and Transfers Out | Controlled Maintenance Funded | Appropriations and Transfers In and Reversions | Interest Earnings | Change in Balance |
| **Subtotals** | **($91,125,000)** | **($36,829,588)** | **($1,000,000)** | **$195,294,256** | **$2,355,144** | **$68,694,812** |
| Percentage of Total Inflows | 46.1% | 18.6% | 0.5% | | | 34.8% |

Controlled maintenance funding accounts for 0.5 percent of total inflows or fund revenue over the 10-year period included in the table, while executive orders for emergencies accounts for 46.1 percent of fund revenue over that period. Additionally, prior to FY 2012-13, there was not much activity in the fund, with the exception of interest earnings which averaged $16,254 over the first five-year period in the table.

It is possible that the negligible balance available in the fund over that period necessarily led to its lack of use for emergency funding over that period; i.e., if there are funds available they will be used for emergencies. Excluding the $20.0 million added in FY 2017-18 to restore the amount used for emergency orders in FY 2016-17, executive orders for emergencies accounts for 51.3 percent and designated appropriations and transfers out account for 20.7 percent of fund inflows.

It appears that the Controlled Maintenance Trust Fund is effectively not funding controlled maintenance as was intended in its creation. It is being used to fund executive orders for emergencies on a regular basis when there is an adequate balance available.

**IN PRACTICE, CAPITAL CONSTRUCTION EXPENDITURES MAY NOT BE PROPERLY DEPRECIATED**

Staff discovered during the interim that at least one state agency fully expensed rather than depreciated its capital construction appropriation. Further, it is staff's understanding that the State Controller's state fiscal rules may be permissive rather than directive in recording depreciation for capital expenditures.

The statutory language that guides the depreciation-lease equivalent payment is based on depreciation. If state agencies are fully expensing their capital construction appropriation on a project in the first year rather than depreciating over the anticipated life of the capital asset, the funding mechanism intended through this provision is never exercised.

For example, a $2.0 million capital renewal project replaces an HVAC system for a correctional facility. The HVAC system is anticipated to have at least a 10-year life by mechanical and accounting standards. In the first year, the proper accounting methodology would require that the $2.0 million expended on the project be recorded as a cash outflow, reducing cash assets by $2.0 million, and also recorded as a $2.0 million increase in capital or long-term assets. Including the first year, over the next 10 years, a depreciation of $200,000 would be recorded as a decrease in capital assets, until the HVAC system is fully expensed on the books. In this case, the department would reflect a depreciation lease-equivalent payment of $200,000 General Fund for every year of depreciation. That payment is a funding mechanism that is routed back into the Capital Construction Fund. Keep in mind, as assets are depleted through depreciation, the cash asset is returned to the capital construction system through this mechanism to ensure that every dollar that would be claimed through depreciation – and in that way billed to the federal government – would be returned to the capital construction system.

However, if instead of depreciating, the department fully expensed the $2.0 million capital renewal project in its accounting books, based on how statute is currently drafted, there would be no depreciation-lease equivalent payment. In this case, the larger weakness is in the permissiveness of the state fiscal rules and oversight from the Office of the State Controller in regards to accounting for capital assets. However, for budget purposes, this defeats the sinking fund mechanism intended by this policy; and that can simply be corrected by requiring that all dollars appropriated in the capital

construction section of the budget be addressed through a depreciation-lease equivalent payment, whether those dollars are depreciated or expensed.

It is staff's understanding, that because of the permissive nature of accounting for capital assets, and because of state agencies propensity to expense rather than depreciate capital expenditures, the Office of the State Controller is likely missing out on payments from the federal government through the statewide indirect cost plan.

Nevertheless, at this time, staff does not wish to attempt to "fix" this problem at the fiscal rules or State Controller level, and instead recommends a solution that addresses the problem specifically related to the depreciation-lease equivalent payment.

## RECOMMENDATION:

**Staff recommends that the Committee pursue legislation:**

**1. To change the name of the Controlled Maintenance Trust Fund to a more appropriately named emergency reserve fund and repeal the references to controlled maintenance in the legislative declaration; or repeal the Controlled Maintenance Trust Fund and create in its place an emergency reserve fund with no connection to controlled maintenance.**

**2. To eliminate depreciation-lease equivalent payment transfers to the Controlled Maintenance Trust Fund** to preserve the purpose of this funding mechanism intended for capital replacement and controlled maintenance. Specifically, staff recommends that the legislation:

- Eliminate the depreciation-lease equivalent payment transfer included in Sections 24-30-1310 (2)(b), C.R.S., to the Controlled Maintenance Trust Fund; and
- Redirect the financing arrangement annual payment for controlled maintenance included in Section 24-30-1310 (2)(c)(II) to the Capital Construction Fund.

**3. To require that all appropriations made in the capital construction section of the budget, excluding appropriations for information technology projects, shall be subject to the depreciation-lease equivalent payment mechanism, whether spending is depreciated or expensed.** If spending is expensed, the entire expensed amount would be reflected in a depreciation-lease equivalent payment in the first budget cycle following the accounting record of the expense just as depreciation is treated for this purpose.

# ISSUE 2: S.B. 14-110 REQUIREMENT TO DEVELOP RECOMMENDATIONS FOR NEW METHODS OF FINANCING CAPITAL CONSTRUCTION

Section 2-3-203 (1)(g), C.R.S., enacted in S.B. 14-110, requires the JBC, in consultation with the Capital Development Committee (CDC), to develop and make recommendations concerning new methods of financing the state's ongoing capital construction, capital renewal, and controlled maintenance needs. This provision requires the JBC to develop and make recommendations by January 1, 2019, and recommend legislation to implement the recommendations by February 1, 2019.

## SUMMARY:

- Senate Bill 14-110 replaced a provision included in S.B. 09-228, which originally required the CDC to develop and make recommendations concerning new methods of financing capital construction prior to the last year of S.B. 09-228 transfers of General Fund to the Capital Construction Fund, placing responsibility with the JBC in consultation with the CDC.

- Section 2-3-203 (1)(g), C.R.S., requires the JBC to develop and make recommendations by January 1, 2019 (the January 1 prior to the last year in which a transfer may be made pursuant to Section 24-75-219, C.R.S., enacted in S.B. 09-228), and recommend legislation to implement the recommendations by February 1, 2019.

## RECOMMENDATION:

1. **Staff recommends that the Committee pursue legislation to repeal or delay the requirement.**

OR

2. **To fulfill the requirement, staff recommends that the Committee introduce legislation by February 1, 2019, to create a capital asset management and finance authority for state agency buildings.**

3. **Also, to fulfill the requirement, staff recommends that the Committee propose addressing capital construction related-funding for higher education institutions in the budget separately from state agencies. Staff recommends that the current, annual, political request process for institution of higher education capital construction be replaced with a capital construction funding formula incorporated into fee-for-service payments.**

## DISCUSSION:

**STATUTES OVERVIEW**

Section 2-3-203 (1)(g), C.R.S. (emphasis added)

> *(1) The committee has the following power and duties:*
> *(g) Prior to January 1 of the year prior to the last year in which a transfer may be made under section 24-75-219, C.R.S.,* ***to develop and make recommendations*** *in consultation with the capital development committee established in section 2-3-1302* ***concerning new methods of financing the state's ongoing capital construction, capital renewal, and controlled maintenance needs****. No later than the following February 1, the committee shall recommend legislation to implement the recommendations.*

Section 24-75-219 (2)(c.7), C.R.S.

> *(c.7) On June 30,2020, the state treasurer shall transfer:*
> *(I) Repealed.*
> *(II) Sixty million dollars from the general fund to the capital construction fund.*

The last year in which a transfer is made using the original formula and trigger provisions in section 24-75-219, C.R.S., is 2020. It appears therefore, that by January 1, 2019, the Committee is required to develop and make recommendations in consultation with the CDC for new methods of financing the State's capital construction. And by February 1, 2019, the Committee is required to recommend legislation to implement the recommendations.

**FUNDING AND FINANCING**

While capital construction transfers have generally been understood and communicated as *funding*, the statute specifies the term *financing*, and more specifically *new methods of financing*.

Funding is generally understood as money provided for a particular purpose. And generally, this is understood as the act of providing financial resources from known and anticipated internal resources.

Financing is the act of obtaining money or capital for a purchase, usually from external sources, with costs allocated intertemporally. Allocating costs intertemporally provides cash flow flexibility while better matching the stream of value or benefits provided or depreciation of assets used up over an extended period of use or lifecycle.

Nevertheless, a source of funding is necessary to support financing activities.

The *annual budget decision* is generally the *funding* model followed by the General Assembly for capital construction. However, it appears that the language chosen for the statute suggests that the intent was to consider new and alternative approaches to pay for capital construction-related expenditures beyond traditional, annual budget decision, lump-sum project funding.

**COMMITTEE OPTIONS**

a. If the Committee prefers that decisions for funding capital construction should continue to be made annually by each Joint Budget Committee in each General Assembly, the Committee should pursue legislation to repeal the requirement.

b. If the Committee prefers to gradually consider and develop options, the Committee should delay the requirement and establish a schedule to reach such an outcome by the new deadline.

c. **Staff recommends** that the Committee introduce legislation by February 1, 2019, to create a capital asset management and finance authority for state agency buildings and that the Committee consult with the CDC regarding this legislation through the legislative process.

   Staff believes that this approach would meet the statutory requirement for developing and making a recommendation for a new method of financing capital construction, capital renewal, and controlled maintenance and for recommending legislation for that purpose.

   Regardless of Committee comfort with and acceptance of this policy concept, initiating a discussion through the legislative process may be the best way to initiate the larger conversation and maintain momentum for this or another solution in a future legislative session.

   Details of a staff-recommended state asset management enterprise can be found in the issue brief that follows.

d. **Staff also recommends** that the Committee propose addressing capital construction related-funding for institutions of higher education in the budget separately from state agencies. Staff recommends that the current, annual, political request process be replaced with a capital construction funding formula incorporated into fee-for-service payments.

   Similar to the prior recommendation, initiating a discussion through the legislative process may be the best way to initiate and have the larger conversation regarding capital construction funding of higher education.

   Additional information is provided in an issue brief that follows.

# ISSUE 3: PROPOSE A CAPITAL ASSET MANAGEMENT AND FINANCE AUTHORITY

The proposal for the creation of a capital asset management and finance authority for state agency buildings would satisfy the requirement that the JBC develop and make recommendations concerning new methods of financing the State's ongoing capital construction-related needs. The authority would be structured as an independent enterprise charged with a primary goal of maximizing the value of capital assets under management (stewardship) and a secondary goal of minimizing lease costs to state agencies (operating cost savings). The authority would be responsible for the lifecycle management of its portfolio of state buildings through the finance, construction, controlled maintenance, renovation, and demolition or sale of capital assets. The authority would lease buildings to state agencies for long-term (near-lifecycle) periods through formal lease agreements, hold ownership of capital assets in trust for the State, and return to the State, a majority of any realized profits on each building at the end of its lifecycle.

## SUMMARY:

- Buildings, facilities, and space needs of state agencies are currently considered and treated in different manners through the legislative approval and state budget process.

- Such disparate treatment makes it difficult to compare average, annual costs of potential state program space solutions and produces potentially irrational, less desirable, and more expensive outcomes in how state resources are spent on state program space needs.

- One option includes the use of private, commercial leased space. Commercial leased space is the highest cost and lowest legislative oversight option; but incremental increases reflected in the annual budget tend to be experienced as reasonable and not too expensive for the budget when compared to the cost from a prior year. Over a building lifecycle, incremental increases become substantial; at which point the General Assembly and the additional cost in the operating budget are well-cooked in the lobster pot.

- A second option is new construction through the capital construction appropriations process. The cost is high during the period of construction and then appears to be zero in the budget for as long as the building is used. The average, annual cost over a 30- to 50-year life of a building is low, but is primarily dependent on available state funds in any given year and whether a project has made its way up the list of priorities over several years, rather than whether the replacement or additional space needs make economic sense for the State.

- A third option is new construction financed through a multi-year, certificate of participation or COP lease-purchase agreement. Similar to the second option, the average, annual cost over a 30- to 50-year life of a building is low. It is not unusual for cash-funded agencies to proceed with COP-financed projects since it is typically a rational economic decision to make 20 to 30 years of lease-purchase payments rather than pay commercial lease rates for the same space over the lifecycle.

- A fourth option is occupancy of existing state building space, such as in the Capitol Complex, which includes an operating budget line item to pay for annual facility operating costs of the Capitol Complex program, but does not include capital asset or facility costs, and so is the least expensive option. Existing space tends to be fully occupied and is dependent on ongoing upkeep through the controlled maintenance process. Typically, the State has not been a good landlord of its properties in this regard in underfunding controlled maintenance and rarely engaging in renovation or facility improvement for its buildings.

- However, good capital budgeting should allocate or reflect costs intertemporally in such a way that if a project is a good idea, then its benefits are apparent in every period compared to the costs for the period. Good capital budgeting should allow program space options to be compared on an average, annual cost basis.

## RECOMMENDATION:

**Staff recommends that the Committee propose legislation to create a state asset management and finance authority for the construction or acquisition of state agency buildings.**

## DISCUSSION:

### GOOD CAPITAL BUDGETING AND INTERTEMPORAL COST COMPARISON

Typically, a capital construction project looks expensive while a project is being built, and then looks inexpensive thereafter. The traditional method and model for funding the state's capital construction reflects this kind of cost pattern. A building project request makes its way up the priority list over several years until it is high enough on the list to be funded with that year's state funds made available for capital construction. After payment for construction, the cost of state program space appears to be nothing. There is no cost reflected in the budget.

Good capital budgeting should allocate or reflect costs intertemporally in such a way that if a project is a good idea, then its benefits are apparent in every period compared to the costs for the period. Depreciation-lease equivalent payments as enacted in Senate Bill 15-211 now provides a method to reflect depreciation of a capital project in the budget for state-funded capital projects. However, the funding method or model is predominantly carried out through traditional, lump-sum funding with state funds as General Fund revenue is available in a given year.

### COMMERCIAL LEASED SPACE AND BUILDING NEW

When a new program is created that requires new space, or a program is expanded, either additional space is found in an existing building or new space is sought. If space is not available in an existing building, typically new space is sought in commercial leased space. The commercial leasing process is managed or overseen statewide by the Office of the State Architect; primarily through the use of contracted brokers and through the use of a standard lease contract.

Once a lease is negotiated and signed, a request item is submitted through the budget process to pay for the contracted lease. Although technically a request item in the budget process, increased appropriations for new leases are typically treated by the Committee as technical adjustments that should be funded rather than as choices that the Committee may or may not fund. There is a practical

understanding that due to the negotiation process for a lease, and the time constraints for signing a lease, the Committee accords the executive branch authority to take care of lease negotiation and approval before the related appropriation is approved through the budget process.

While commercial leased space is a flexible space-expansion option, particularly for incrementally-expanding state programs, it is also the most expensive state agency space option. A commercial lease must include the private owner's actual facility costs – either construction and financing or depreciation/economic opportunity cost – leasehold improvement costs required by the program for the space, any major maintenance items necessary in the space over the period of the lease, and the landlord's administrative and operating expenses as well as profit. In the commercial leased space option, the full cost of the facility, plus management expenses and profit, is paid in the lease.

When a capital construction project is funded with state funds, typically the cost is paid in a lump sum at the front end of the project. Controlled maintenance may be paid by the state in the capital construction budget after the building is 15 years old; but controlled maintenance is not paid by the state agency in its operating budget as a controlled maintenance item would be included in a lease payment in an equivalent commercial leased space payment. Other improvements to the building to better accommodate program changes could be requested for funding through the capital construction process. However, in comparison, a lease renewal in commercial leased space could incorporate necessary space changes based on changed program needs; and those costs would be included in future lease payments made in the state agency's operating budget.

As illustrated in this comparison, as it relates to flexibility and quality of space, it is to a state program's advantage to locate in commercial leased space, despite that the cost is the most expensive to the state. Between flexibility over amount and quality of space needs over time, to the need to acquire prior approval through the budget process, leasing commercial space is the easiest choice to consider for a state agency, and yet is the most expensive and offers the least amount of legislative oversight.

State programs with generic office or warehouse space needs can readily find commercial leased space opportunities. However, more specialized state programs that include corrections and human services facilities often require specialized buildings that are not generally available for commercial lease. It is not unusual that these programs rely on lump-sum state funding or COP-financed projects for their space needs. And because of this, the need for new space has to rise to such a high level in criticality, that replacement of facilities or construction of additional space comes well after program need and economic justification might be established.

Over the last few years, staff has discussed issues related to the importance of prioritizing funding for controlled maintenance and recapitalization and has recommended increased commitment for those needs. Included in those discussions is a general, underlying conclusion that the State has not consistently and appropriately maintained its buildings and capital assets. Staff has argued that this is partly a function of the bifurcation of the capital construction budget from the operating budget in addition to the conventional explanation of the battle for limited resources that affects all areas of the budget.

The capital construction budget is generally viewed as containing projects funded by state money that is available after all operating budget issues have been addressed. While that is a simplification, capital construction and even more importantly, controlled maintenance and recapitalization, have often been approached as optional funding items in difficult budget years. And while it is true, generally, that the

State can choose to not fund controlled maintenance in a given year, it cannot make that a regular practice without paying a much higher price for the cost of addressing deferred maintenance and additional building system failures that lead to the loss of use of program space.

As previously mentioned, provisions enacted in S.B. 15-211 now require that depreciation from capital projects be reflected in the operating budget for capital projects funded in the Long Bill in or after FY 2015-16. This will help to level the playing field as it relates to how state-funded, capital construction projects are reflected and viewed and considered in the budget relative to commercial leased space payments. However, it is also possible to consider a new method of financing state agency capital construction needs using the models of private commercial leased space and real property asset management.

**REAL PROPERTY ASSET MANAGEMENT**

Real property asset management is a process of decision-making and implementation regarding real property acquisition, use, and disposition assuring that a property is operated for optimum short-term and long-term performance, including fiscal sustainability and enhancement of value. Asset management can also be described as a systematic process of deploying, operating, maintaining, upgrading, and disposing of assets cost-effectively over every year of an asset's lifecycle.

Asset management proactively matches real property management and property development with customer needs over defined and planned periods of time. Asset management objectively prices property lease payments and property management services to ensure financial sustainability through operating cash flow and reserves for real property lifecycle planning – acquisition, use, and disposition – that maximizes asset value for cost.

**A CAPITAL ASSET MANAGEMENT AND FINANCE AUTHORITY**

A capital asset management and finance authority, structured as an independent state enterprise, and charged with a primary state policy goal of maximizing value of capital assets under management, would be responsible for the lifecycle management of state buildings through the financing, construction, controlled maintenance, renovation, and demolition or sale of capital assets at the end of the building or facility lifecycle. The authority would:

- finance the construction of buildings through bonding authority;
- lease those buildings to state agencies for 20 to 50 years (long-term, lifecycle or near-lifecycle);
- provide facility improvements or expansion (renovation) in conjunction with state agency facility planning through the lifecycle;
- hold ownership of each discrete capital asset in trust for the State; and
- upon disposal, return to the State a majority of any realized profit at the end of the facility lifecycle.

A lease rate would include the cost of construction and financing as well as an amount to pre-fund all necessary future controlled maintenance. The lease rate could include day-to-day facility operating costs if the state agency is not staffed to handle facility operating responsibilities. And the authority would be funded through administrative or operating fees collected through lease payments.

While such a fee or fees would be nominally more expensive than the current model of lump-sum, state funded capital construction, fees in lease rates would be less than the expenses and profit included in rates for commercial leased space. The charge to maximize value would ensure that lease rates would include the full lifecycle cost of the facility – financing, construction, maintenance, renovation, and demolition or sale – and administrative and operating costs for the authority, but exclude profit. Any profit realized at the conclusion of a facility lifecycle could be returned to the State through a profit-sharing requirement that returns the largest portion of any profit to the State; such profit would reflect an overpayment by the State for the facility over its lifecycle.

A finance authority with bonding authority would provide the State with a method for the immediate or near-term construction of state agency buildings that does not rely on the current availability of a lump sum amount of state funds to fund the full construction cost of state buildings. As previously addressed, the lease rates paid in the operating budget for such authority-financed, –constructed, and –owned buildings should not be any more expensive on an annual basis than current payments reflected in operating budgets for state agencies leasing commercial space. Costs and cash flow reflected in the operating budget would be similar to COP-financed projects but would reside in a *closed-loop or sealed portfolio* held in trust and beyond the realm of State budget responsibility for ongoing capital maintenance costs.

Authority lease payments may increase the on-budget operating cost of some programs which previously occupied state-owned buildings. However, future decision making for changes to state program facility needs will be enhanced with clear and accurate cost information regarding options for a variety of levels of facility quality.

Specialized state buildings, such as for Department of Human Services programs in need of replacement due to policy change like the Grand Junction Regional Center, or due to general deterioration, would be reflected in the operating budget for the first time. However, in cases where such programs rely on federal funds, it is staff's understanding that federal payments for services may be collected to pay for lease payments but not for capital construction. Such federal payments for traditional capital costs can only be captured through the depreciation and statewide indirect cost process. This suggests that the proposed authority would enable a more direct method of receiving federal dollars for capital costs for federally-supported program facilities.

**STATUTORY FINANCE AUTHORITIES**

Currently, statute includes two facility construction and finance authorities which provide a statutory model for the recommended authority. The Colorado Educational and Cultural Facilities Authority located in Article 15 of Title 23, C.R.S., and The Colorado Health Facilities Authority located in Article 25 of Title 25, C.R.S., include legislative declarations which encompass authority that is suggested for a state building asset management and finance authority:

> *It is the intent of the general assembly to create the Colorado educational and cultural facilities authority to lend money to educational institutions and cultural institutions; to authorize the authority to acquire, construct, reconstruct, repair, alter, improve, extend, own, lease, and dispose of properties…*
>
> *It is the intent of the general assembly to create the Colorado health facilities authority to lend money to health institutions and to authorize the authority to acquire, construct, reconstruct, repair, alter, improve, extend, own, lease, and dispose of properties …*

These authorities' statutes provide broad authority for the finance and construction of facilities with additional specified authority to generate lease revenue and collect fees in an asset management role. Although staff is not familiar with the operations of these authorities, it is likely these authorities primarily provide financing assistance and opportunity to qualified entities at the building project initiation end of the lifecycle without engaging in full lifecycle asset management and leasing. Nevertheless, existing statutes for these authorities provide the kind of full lifecycle, asset management envisioned for the capital asset management role of the proposed authority.

**ADVANTAGES**

Some basic advantages of the authority model include:

- A more economically rational or business-based approach to asset management and stewardship of state resources rather than one based on political decision-making.

- As facilities are built through the authority, the State's need to fund controlled maintenance for state agency buildings will be reduced overall and eliminated for all new buildings. Funding for controlled maintenance would be included in lease rates paid in the operating budget similar to commercial leased space payments.

- The elimination of the budgetary conflict about adequate funding for capital construction and controlled maintenance after operating expenses have been determined. Capital construction – fundamentally, the cost of state agency program space needs – will receive its funding through the operating budget in the form of a lease payment that is equal to the annual lifecycle cost of the space.

**AUTHORITY STRUCTURE**

While statute provides guidance in format for existing facility authorities, the keys to the creation of a well-functioning authority include:

- **A governing board with shared legislative and executive branch participation.** Staff recommends a governing board consisting of seven members as follow:
  - The Chairman and Vice-chairman of the JBC;
  - The Chairman and Vice-chairman of the CDC;
  - The Director of the OSPB;
  - The State Architect; and
  - The State Treasurer.

- **Legislative and State Architect oversight of building project construction and purchase approval.** Staff recommends that the CDC provide legislative oversight of project approval through the CDC process and include State Architect oversight through the state agency statewide planning process.

- **State Treasurer approval and oversight of financing activities.**

- **State Auditor review of accounting and financial sustainability practices.**

- **Specified State policy goals regarding (1) asset value maximization and (2) lease cost minimization.**

- **Transparent reporting of measures of achievement through an annual asset management plan that includes measures of customer service and authority accountability.**

- Due to the fiduciary emphasis on sustainable financial management of capital assets, **an organizational compensation structure that incentivizes meeting and exceeding annual, asset management (value generation and cost containment) and customer service goals.**

# ISSUE 4: PROPOSE DISTINCT HIGHER EDUCATION CAPITAL CONSTRUCTION FUNDING

Institutions of higher education hold 74.5 percent of the state's building inventory. In comparison to state agencies, institutions of higher education, as enterprises, are treated with a substantial degree of independence and have access to multiple sources of revenue beyond state funding. Institution of higher education building projects follow a separate request and approval process as established through the Colorado Commission on Higher Education (CCHE). In order to more effectively manage capital construction budgeting for state agency buildings, it may be appropriate to consider a separate and distinct system or model for capital construction funding and budgeting for institutions of higher education through a funding formula distribution in fee-for-service contract payments

## SUMMARY:

- Institutions of higher education hold 74.5 percent of the state's building inventory with a current replacement value of $8.8 billion; an increase of 185.7 percent since FY 1998-99; and an increase from 73.1 percent in the prior year and 72.5 percent in the year before that.

- The State Architect's recommended funding of 1.0 percent of current replacement value annually for state agency buildings is $33.0 million compared to $96.7 million for institution of higher education buildings.

- Institution of higher education building projects follow a request and approval process as established through the Colorado Commission on Higher Education (CCHE); state agency buildings follow a request and approval process through the Office of the State Architect.

- The politically competitive state funded request process creates inefficiencies through statewide lobbying resources spent in political competition; creates "queuing", "bundling", and "phasing" of projects which may lead to distortions away from rational capital asset management; and possibly rewards emergency need over practices that enable good stewardship.

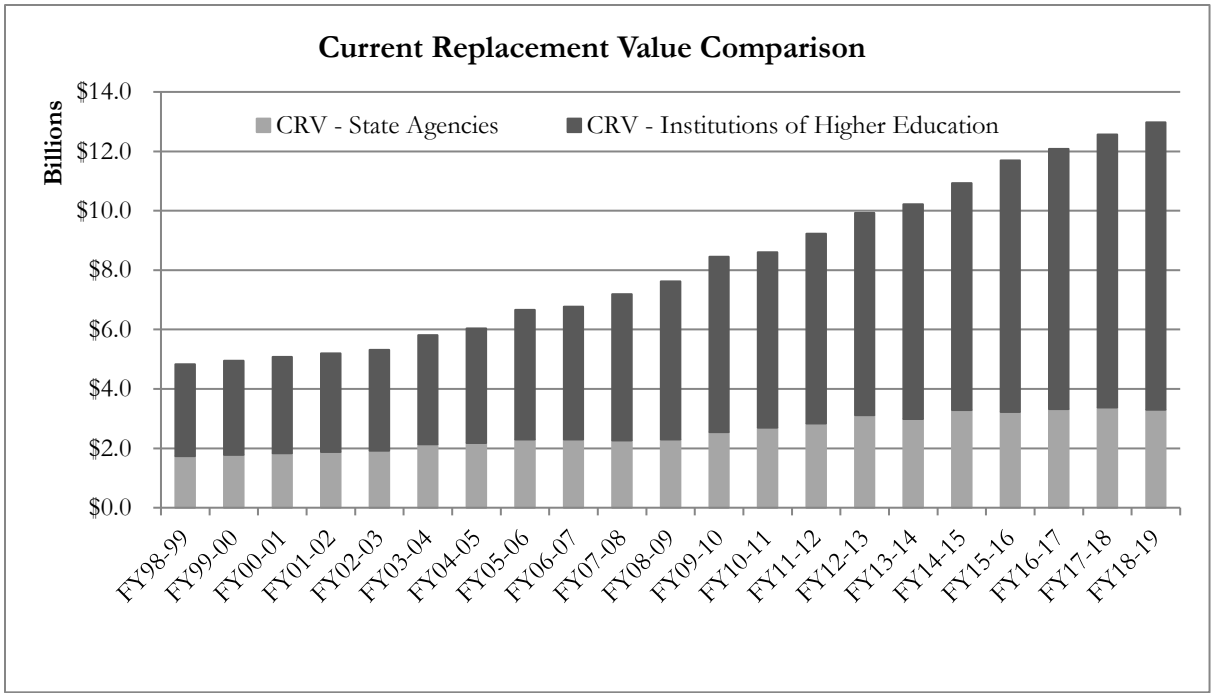
- Institutions should be empowered to engage in a proactive approach to capital construction and controlled maintenance needs whether planning for academic or auxiliary buildings through the use of a relatively predictable and equitable revenue source for capital over time.

## RECOMMENDATION:

**Staff recommends that the Committee propose legislation and adopt Committee policies to fund institution of higher education capital construction and controlled maintenance through a funding formula distribution in fee-for-service contract payment appropriations.**

## DISCUSSION:

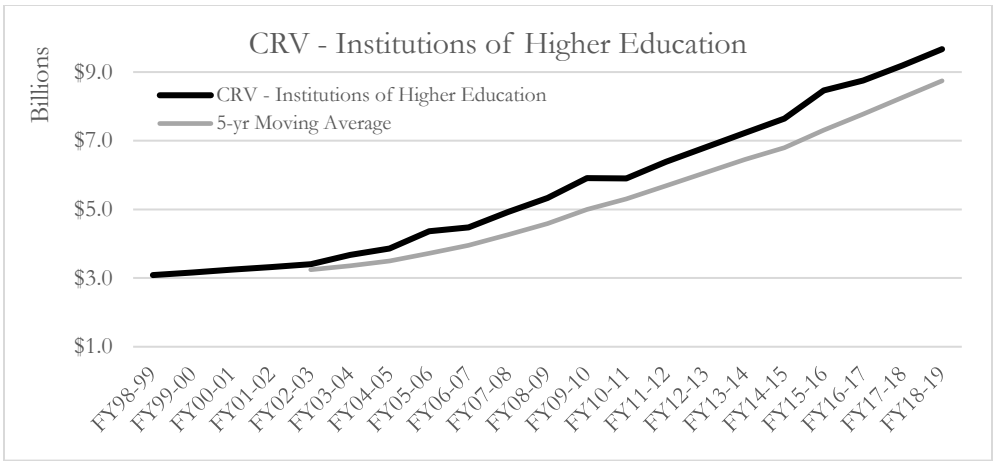
As previously discussed in factors driving the budget, institutions of higher education hold the largest portion of the state's building inventory. The following chart outlines the current replacement value of academic buildings at institutions of higher education and state agencies since FY 1998-99. The higher education total does not include the value of non-academic buildings, which are not provided state-funded controlled maintenance.

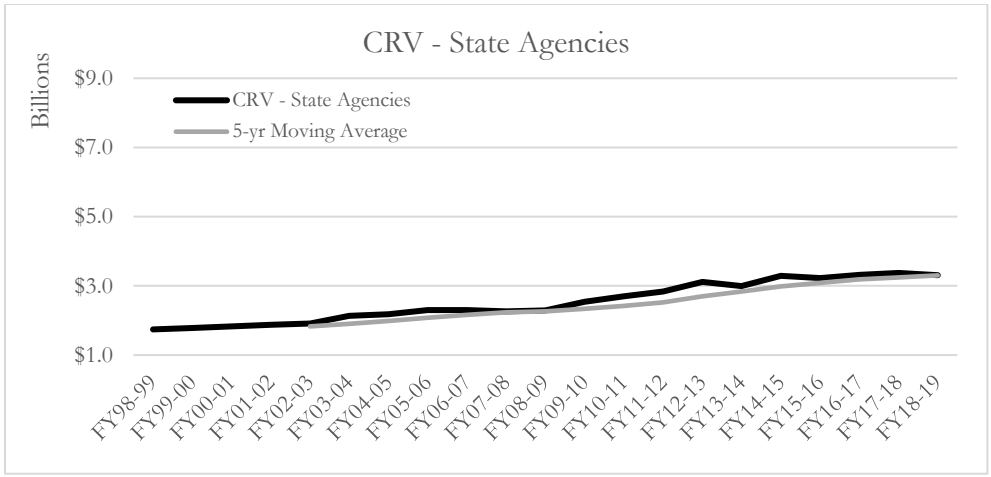



In the current fiscal year, the current replacement value for state agency buildings totaled $3.30 billion, representing a decrease from $3.37 billion in the prior year. The current replacement value for institutions of higher education totaled $9.67 billion, representing an increase from $9.19 billion in the prior year. State agencies and institutions of higher education represent 25.5 percent and 74.5 percent of the $12.97 billion state building inventory, respectively.

In FY 1998-99, current replacement values totaled $1.74 billion and $3.09 billion, respectively, representing 36.1 percent and 63.9 percent of the $4.83 billion total state building inventory.

The state agency building inventory increased 85.1 percent over the 21-year period shown in the chart, a compound average growth rate of 3.0 percent per year, while the institutions of higher education building inventory increased 205.5 percent over that period, a compound average growth rate of 5.5 percent per year. The following charts reflect the change in CRV for each.



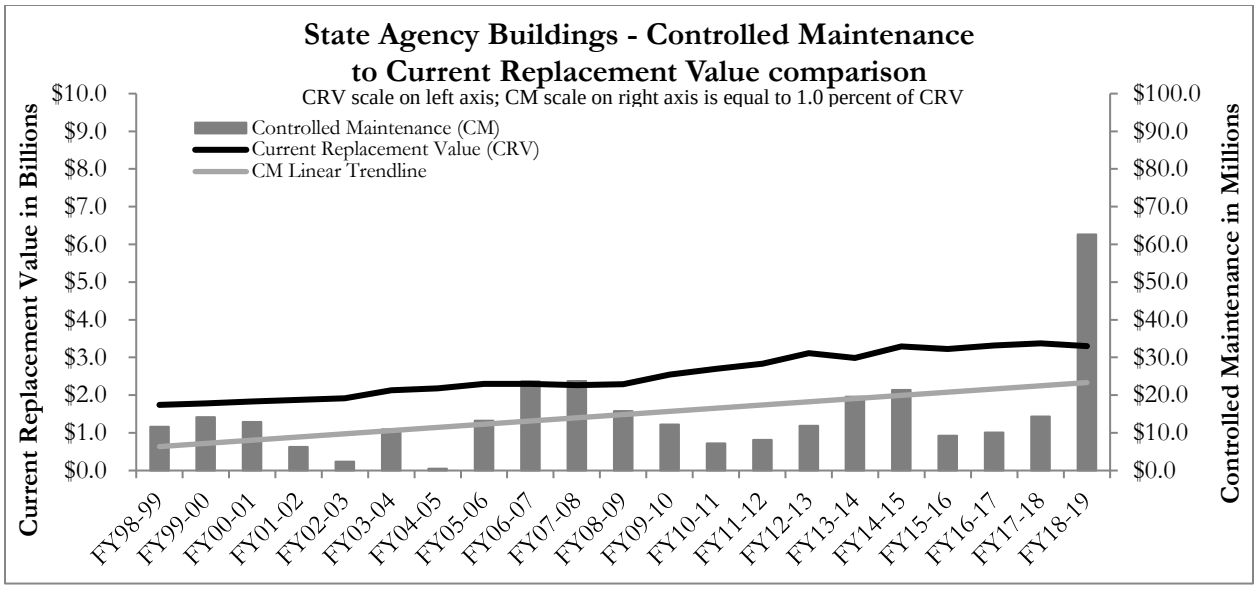

Gross square footage increased 23.2 percent and 47.1 percent over that period for state agency and institution of higher education buildings, respectively; a compound average growth rate of 1.0 percent and 1.9 percent per year, respectively.

The State Architect's recommended 1.0 percent funding for controlled maintenance in FY 2018-19 would have totaled $33.0 million for state agency buildings and $96.7 million for institution of higher education buildings. Controlled maintenance appropriations and state funding from collateralization in FY 2018-19 totaled $62.6 million for state agency buildings, representing 189.6 percent of recommended and $66.3 million for institution of higher education buildings representing 68.6 percent of recommended. Other recapitalization (capital renewal and renovation) appropriations from state funds in FY 2018-19 provided an additional $39.8 million and $33.8 million for state agency and institution of higher education buildings, respectively.

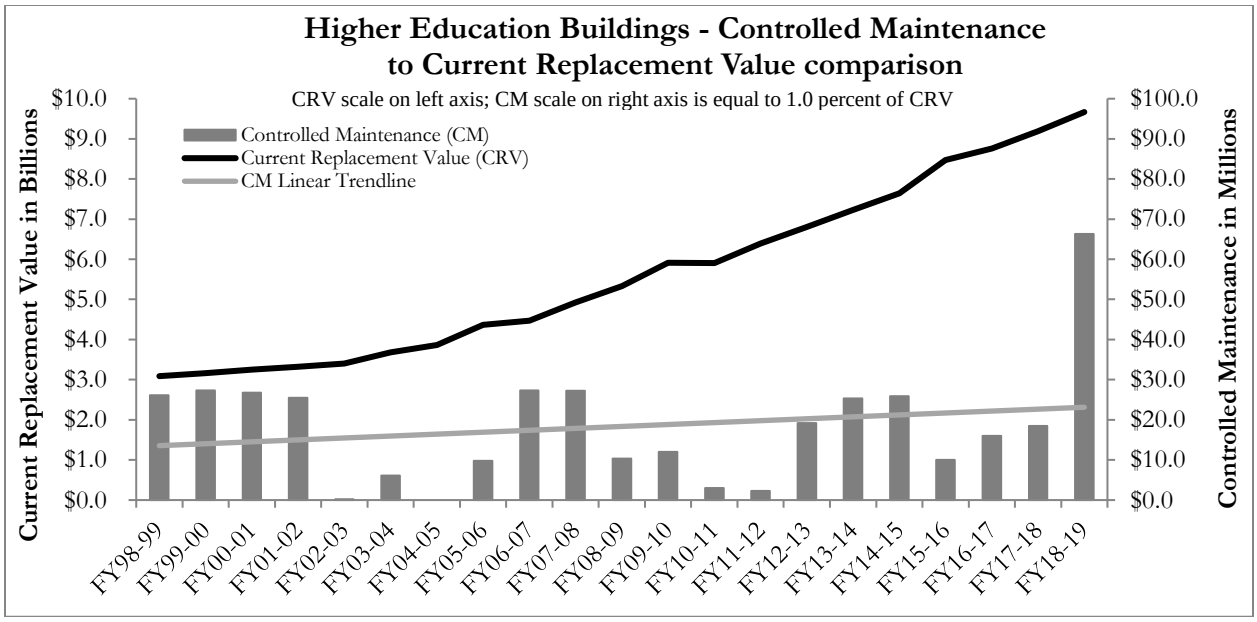
Just over $6.5 billion of building inventory for institutions of higher education has been added since FY 1998-99 and $5.8 billion has been added in the last 15 years. The general condition of newer building stock requires less controlled maintenance. However, the State begins funding controlled maintenance for buildings at 15 years. The building inventory added after FY 2004-05 has not yet qualified for controlled maintenance funding, but will qualify beginning in FY 2019-20.

**THE DISTINCT NATURE OF CAPITAL CONSTRUCTION FUNDING FOR HIGHER EDUCATION**

The following charts reflect controlled maintenance funding to CRV for state agency buildings and for institution of higher education buildings.

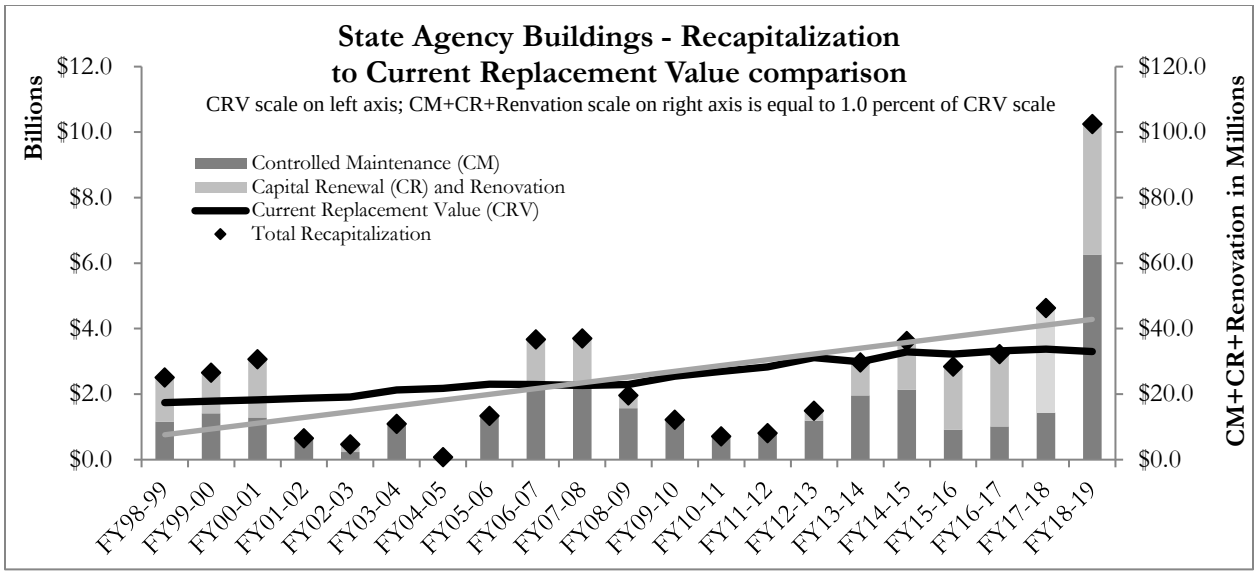



The increased state funding provided in FY 2018-19, causes the trend line to increase over the period in the chart. Graphically, this suggests that funding 1.0 percent for controlled maintenance for state agency buildings every year is not that far out of reach. In fact, level state funding of $33.0 million would achieve 1.0 percent funding for controlled maintenance for state agency buildings.

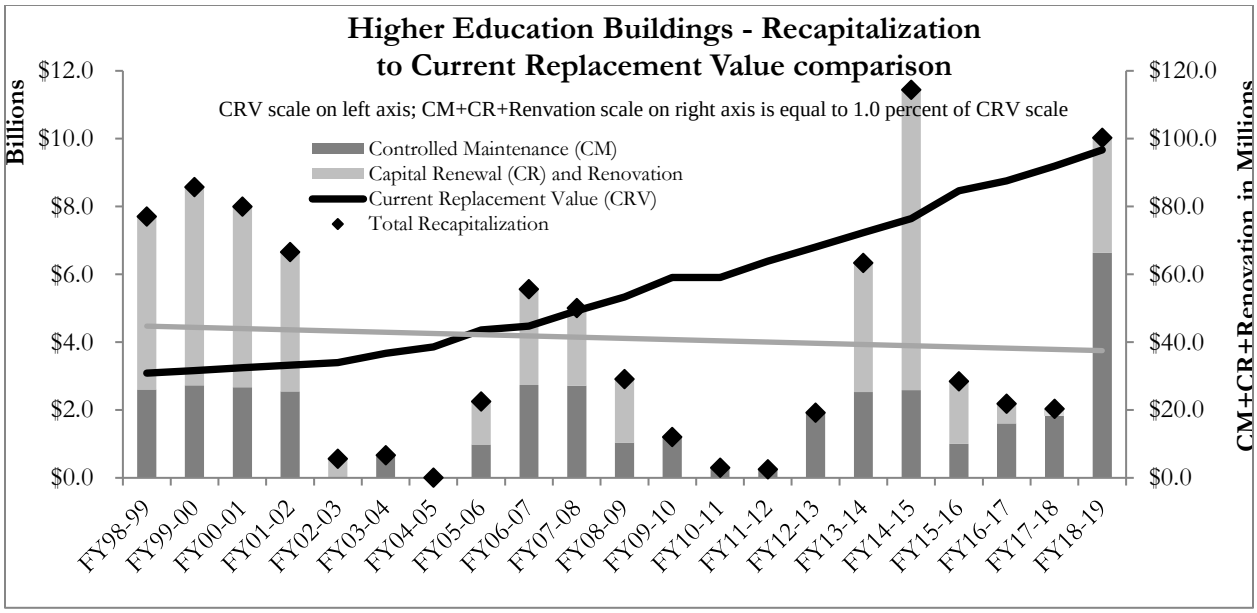



Similarly, the increased state funding in FY 2018-19 has the trend line slightly increasing over the period in the chart. However, the spread between the CRV and trend lines is widening over time. State funding for 1.0 percent of CRV for higher education would cost $96.7 million and is increasing.

The following charts reflect recapitalization funding to CRV for state agency buidings and for institution of higher education buildings.




This recapitalization to CRV chart for state agency buildings suggests that recapitalization has generally been reaching and exceeding 1.0 percent of CRV, including an upward sloping trend line. Ideally, other recapitalization funding might equal another 1.0 percent on top of controlled maintenance funding of 1.0 percent. Nevertheless, because of the reasonable and stable state agency building inventory, such a funding effort is not an extraordinary budget lift.

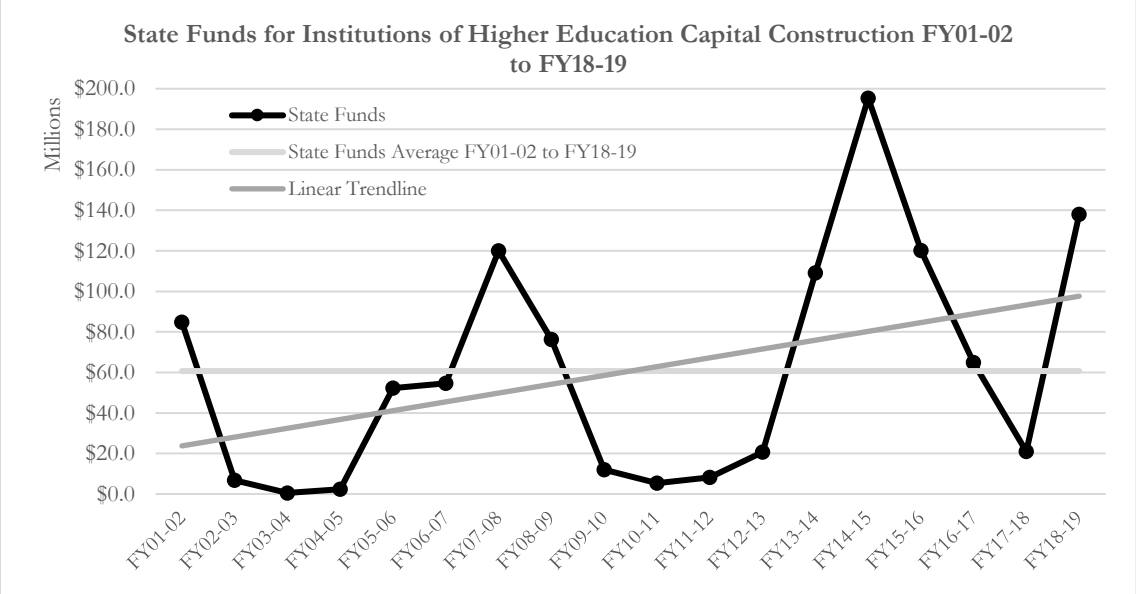



The higher education recapitalization to CRV chart incudes a downward sloping trend line, even with the additional funding provided in the current fiscal year. It includes the increasing CRV line that is

increasingly diverging from the trend line. Funding an additional 1.0 percent for other recapitalization would cost an additional $96.7 million.

**STATE FUNDING HISTORY**

The following chart reflects only state funds provided for institutions of higher education capital construction since FY 2001-02. Funding included for FY 2018-19 reflects statutory funding provided from state building collateralization COPs enacted in S.B. 17-267.




State funding has averaged $60.7 million per year over the 18-year period included in the chart. However, as illustrated in the chart, state funding for capital construction has varied substantially from year to year based on the availability of General Fund in a given budget year. Any economic growth and multiplier effects generated from capital construction spending in a given year reinforces the business cycle; multiplier benefits to the economy from construction spending are generated when the economy is already healthy and reduced when the economy is depressed. Additionally, capital construction spending is down in economic down years when construction costs are likely to be more affordable and up in economic up years when construction costs are likely to be more expensive.

**INEFFICIENCIES OF THE POLITICALLY COMPETITIVE STATE FUNDED REQUEST PROCESS**

For cash-funded auxiliary buildings and structures, institutions take a proactive approach to their buildings, facilities, and campus needs. It is a rational business decision to project cash fund revenue from an auxiliary facility project and then generate revenue with the facility which pays for project financing. Similarly, it is also a relatively straightforward business decision whether to maintain, upgrade, or eliminate auxiliary facilities based on revenue and cost projections, customer usage, and long-range campus planning.

Institutions may occasionally take a proactive approach to their academic buildings such as when donors step forth to fund an academic building or when an institution determines that it cannot wait for the State to fund an academic building, renovation, or repair and moves forward on a project using institutional funds. However, it is not unusual for institutions to take a traditional approach to seeking state funds for academic buildings: creating a wish list and then lobbying aggressively and generally

engaging in competitive political positioning relative to other institution and state agency capital requests, typically over several years for any single project.

This "politically competitive" approach is not surprising for a state-funded process; it is the approach parties involved in the budget process expect, understand, and accept as a part of the budget process. But on a statewide basis, this approach expends institutional resources in political competition that could be more productively invested in capital asset management.

Additionally, the resources available to institutions of higher education relative to state agencies for lobbying creates an immediate, uneven playing field in the competition for funding. And it does so in a competition for two very different things that are fundamentally and significantly different in scale and scope relative to fairly distinct public policy ends and goals.

While institutions generally make requests annually, they are also aware of the concept of "waiting their turn" for project funding. This "queue" approach to capital funding likely helps those institutions that happened to be "next in line" during a good funding year while limiting those institutions that happened to be "next in line" during a poor funding year. The queue approach gives the appearance of fairness over the long run – at least conceptually, but definitely not in a given year and possibly unevenly over the long run. The queue approach may also have the tendency to fund a "next in line" project request ahead of one with greater need or a greater return on investment for the State.

And further, as a part of budget decision making, should institutions be rewarded for need – possibly indicating poor management and maintenance of campus facilities, infrastructure, and building systems? Or should institutions be rewarded for lack of need, which might suggest an institution's good stewardship of capital resources? If need is funded to a greater extent, perhaps there is an incentive built into the process for institutions to be lax about management and maintenance.

Funding provided on a formula basis tied to the on-campus (not online) student headcount in particular would provide a fair distribution of resources annually on which institutions might better plan their capital construction-related spending. Institutions growing their student base over time would be automatically, annually rewarded for that growth; institutions with a flat or declining student base would have to make decisions directly tied to campus size on that basis. And regardless, such adjustments would occur annually and incrementally, rather than all at once, and so would necessitate effective and sustainable long-term planning as it relates to state resources for higher education capital construction funds.

It also appears that institutions may make larger than necessary, "bundled", and multi-year, "phased" requests. Institutions seek space for multiple program needs that could, and possibly even should, be addressed separately. However, because of the queue process, it is in their interest to maximize their opportunity for total state funding for capital construction through a larger, bundled project approach that will address several campus needs in a single funding decision.

These are some of the inefficiencies and distortions away from rational enterprise management that are generated through the current, politically competitive process for project funding.

**A "CAPITAL FEE-FOR-SERVICE PAYMENT" FOR INSTITUTIONS OF HIGHER EDUCATION**

The current and foreseeable state of revenue limits and budget commitments leads to a reduced ability for the State to provide capital construction funding generally. Due to the additional revenue sources

available to institutions of higher education for capital expansion, state funding for capital construction for institutions of higher education should be directed more toward controlled maintenance, capital renewal, and recapitalization rather than new construction.

Further, given the independent nature of the enterprise status of institutions of higher education, the State should consider moving away from funding capital construction on a project basis and toward a system of providing funding to be distributed through an allocation formula. Staff would recommend an allocation based on student head count, which would have the effect of tying state funding for capital construction to student population and provide consistency over time.

Institutions of higher education should engage in a proactive, enterprise-management approach to capital construction and controlled maintenance, whether planning for academic or auxiliary buildings. A generally consistent, relatively predictable revenue stream, with an annually fair and transparent funding formula across all institutions would allow institutions to manage and maintain academic facilities in a business rational manner similar to that for auxiliary buildings, while reducing expenditures of energy and resources made through the politically competitive state funding process.

**RECOMMENDATION**

**Staff recommends that the current, annual, political request process for institution of higher education capital construction be replaced with a capital construction funding formula incorporated into fee-for-service payments.**

Such a formula would ensure that the State is providing annual capital construction funding on an equitable basis across all institutions. While this approach would eliminate annual capital construction budget decisions and JBC involvement for institutions, the Capital Development Committee would continue to be charged with overseeing and approving all institution of higher education capital construction projects through existing approval processes.

The implementation of this funding model as an annual appropriation in the operating budget will contribute to a more consistent funding pattern from year to year. The advantage to institutions is more reasonable control over a revenue stream that is generally consistent and reliable.

This model would provide institutional control over funding new construction, renovation, controlled maintenance, or payments toward capital construction debt for academic facilities with the amount provided by the capital fee-for-service payment. Such a model would encourage institutions to make better long-range decisions regarding the maintenance, upgrade, or elimination of academic facilities. and would have the effect of rewarding institutions that are the most efficient and effective at planning and managing capital assets over many years.

# ISSUE 5: DHS FACILITIES MANAGEMENT PRACTICES AND CAPITAL CONSTRUCTION REQUESTS

The Department of Human Services (DHS) has requested substantial capital construction funding related to "competency services" for FY 2018-19 and FY 2019-20, including $15.3 million of a $34.2 million project to convert the Ridge View Youth Services Center to a mental health restoration facility. In an issue brief from the November 2015, Capital Construction Budget Briefing, JBC staff identified issues and concerns with Department facilities management practices which the Department has not changed or improved. The JBC staff analyst for the DHS behavioral services programs has expressed concerns and reservations about funding the Department's capital construction request related to competency services from a program perspective. For other reasons related to good stewardship of state assets, the JBC staff analyst for capital construction also cannot recommend additional state funding of DHS capital construction requests based on the continuing concerns and issues cited in that issue brief that have never been corrected.

## SUMMARY:

- The Department of Human Services requests a $34.2 million state funded project to convert the Ridge View Youth Services Center to a mental health restoration facility, with funding requests of $3.7 million Capital Construction Fund (CCF) for FY 2018-19 and $11.5 million CCF for FY 2019-20. The capital construction project leads to an estimated $62.1 million per year operating budget program build-out for competency services.

- The JBC staff analyst for the DHS behavioral health programs operating budget has expressed concerns and reservations about proceeding with the Department's direction in funding additional beds for competency-related evaluations and treatments instead of seeking a wider spectrum of statewide policy options for addressing the competency services issue.

- In the November 2015, Capital Construction Budget Briefing, current JBC staff presented an issue brief which recommended the creation of a state asset management enterprise for the financing, construction, and ownership of DHS facilities. Such an entity would function in the role of a commercial property owner and lease buildings and facilities to DHS programs at cost – financing, construction, maintenance – plus the administrative cost of the enterprise. While the recommendation was a large policy step for the State to make regarding financing, construction, and ownership (long-term maintenance and asset value maximization) of state buildings, and was not pursued at the time, the issue brief identified specific and general problems with DHS facilities management practices that have historically led and will continue to lead to poor stewardship of state capital assets over time.

- Fundamentally, the Department pays for – or bills its divisions and programs for – its facilities management costs through its indirect cost plan. Indirect cost methodology typically uses a proportional assessment based on FTE or personal services appropriations rather than "direct costing" and "direct billing" for discretely identifiable costs by division or program. The more difficult it is to identify discrete services or to price or collect a fee for generally provided, administrative overhead services, the more appropriate it is to use an indirect cost allocation. So

while indirect costs are a reasonable method for apportioning human resources or accounting costs, it is not reasonable to apportion facility costs through an indirect cost plan when such costs can and should be discretely identified by facility, building, and program because of the facility-centric and facility-specific nature of the Department's programs.

- The fatal weakness of the indirect cost approach is the lack of a clear price or cost signal provided to the end user for the cost of those services. Services appear to be "free"; or if not free, then equally billed across all programs on an FTE-proportional or similar basis, which disperses specific program costs across the collective of Department programs. This reduces the ability of program managers and decision makers to consider facility condition, improvement, and change as a method of improving program outcomes on a cost-benefit decision spectrum. The actual facility costs for programs, particularly for facility-centric programs located in specialized, 24-7, residential and treatment facilities, is vague and generally unknown.

- The end user is the division or program manager, program constituencies, as well as state elected officials and policy staff. Policy makers lack cost information and are essentially "flying blind" when it comes to making rational, cost-benefit decisions related to facility improvement or replacement; and decisions have traditionally been guided by the "public emergency" nature of the Department's facility needs.

## DISCUSSION:

### THE DEPARTMENT OF HUMAN SERVICES REQUEST

The Department requests $34.2 million in state funds for its Secure Treatment Facility for Mental Health Restoration. The Department requests first phase funding in FY 2018-19 of $3.7 million Capital Construction Fund (CCF) for design; and second phase funding for FY 2019-20 of $11.5 million CCF for infrastructure, utilities, and site improvements. The third phase for FY 2020-21 totals $18.9 million CCF for construction. The project renovates and converts the Ridge View Youth Services Center, with the capacity to serve 500 youth, of which 160 beds were in use in October 2018, to a mental health restoration facility with 210 beds.

### CONCERNS OF JBC ANALYST FOR DHS BEHAVIORAL SERVICES PROGRAMS

The Department's capital construction request narrative states that it anticipates operating costs beginning in FY 2020-21 to be similar to those experienced at the Colorado Mental Health Institute at Fort Logan (CMHIFL) of approximately $810 per person per day; or $62.1 million per year at full capacity.

The JBC staff analyst for the DHS behavioral health programs operating budget has expressed concerns and reservations about proceeding with the Department's direction in funding additional beds for competency-related evaluations and treatments instead of seeking a wider spectrum of statewide policy options for addressing this issue.

### CONCERNS OF JBC ANALYST FOR CAPITAL CONSTRUCTION

In the FY 2016-17 capital construction budget briefing, presented in November 2015, current JBC staff presented an issue brief in which staff identified issues and concerns with the Department's facilities management practices, which staff continues to believe have historically led to and will

continue to lead to poor stewardship of state capital assets. For reference, that issue brief is attached as Appendix D at the end of the briefing document.

During the 2015 interim, JBC staff visited many of the Department's facilities across the State. In most cases, JBC staff visited with staff from the Division of Facilities Management (DFM) and the Office of the State Architect (OSA) to gain a better sense of the condition of facilities and the challenges faced by staff at the DFM.

In data analysis conducted on facility condition measures, historical controlled maintenance, capital renewal, and recapitalization funding, staff determined that DHS facilities appeared to be in poorer condition relative to other state agency buildings and facilities. JBC staff also concluded in that issue brief that the staff at DFM appear to take care of DHS facilities at a lower cost per square foot than Capitol Complex. While the Capitol Complex includes more expensive buildings generally, in a more expensive location, DHS facilities include 24-7 residential and clinical care treatment facilities, in many cases set on traditional campuses with complex and high-maintenance, campus-wide mechanical and electrical infrastructure, with facilities spread across the State. Nevertheless, the difference was identified as approximately two-thirds the cost - $5.48 per square foot versus $8.24 per square foot.

From site visits that included visual observation of internal building systems and building envelope components as well as discussion with DFM and OSA staff, JBC staff concluded that the staff at DFM appeared to be doing everything possible with the funds provided by the Department. Through informal conversations with DFM and OSA staff, JBC staff inferred that the Department absolutely caps the budget for DFM regardless of actual need through the year. When a need arises that was unanticipated, as regularly occurs, the DFM are forced to forego repair or maintenance of another item.

To be clear, emergency controlled maintenance issues for the failure of a building system would still be routed and likely funded through the OSA. The difference between annual facility maintenance provided in an operating budget and controlled maintenance provided in the capital construction budget is annual maintenance refers to repairs and maintenance intended to benefit a facility for a year or less; while controlled maintenance is the replacement of building systems intended to provide a benefit longer than one year. The DFM attend to – or pay for out of their budget, staff and materials for – annual repair and maintenance issues of DHS buildings, facilities, and grounds.

So while staff found that the DFM staff were doing an exceptional job given unusually limited resources, the Department's management practices and budget practices as they relate to facilities management appear to be the source of the problem.

Fundamentally, the Department pays for – or bills its divisions and programs for – its facilities management through its indirect cost plan. Indirect cost methodology typically uses a proportional assessment based on FTE or personal services appropriations rather than "direct costing" and "direct billing" for discretely identifiable costs by division or program.

The more difficult it is to identify discrete services or to price or collect a fee for generally provided, administrative overhead services, the more appropriate it is to use an indirect cost allocation. So while indirect costs are a reasonable method for apportioning human resources or accounting costs, it is not reasonable to apportion facility costs through an indirect cost plan when such costs can and should

be discretely identified by facility, building, and program because of the facility-centric and facility-specific nature of the Department's programs.

The weakness of the indirect cost approach is that there is not a clear price or cost signal provided to the end user for the cost of those services. Services appear to be "free"; or if not free, then equally billed across all programs on an FTE-proportional or similar basis, which disperses specific program costs across the collective of Department programs. This reduces the ability of program managers and decision makers to consider facility condition, improvement, and change as a method of improving program outcomes on a cost-benefit decision spectrum. The actual facility costs for programs, particularly for facility-centric programs located in specialized, 24-7, residential and treatment facilities, is vague and generally unknown.

The end user is the division or program manager, program constituencies, as well as state elected officials and policy staff. Policy makers lack cost information and are essentially "flying blind" when it comes to making rational, cost-benefit decisions related to facility improvement or replacement; and decisions have traditionally been guided by the "public emergency" nature of the Department's facility needs.

While the indirect cost budget and funding approach to facility management cost is a fundamental problem, the Department's approach to managing its facilities and capital assets is an approach best described as "facility funding by crisis" and is a strategic approach entirely tied to advancing its program goals.

DHS is a particularly program-intensive state agency, delivering a fairly complex spectrum of client care services. It is reasonable that such a program-intensive department will focus its energy on the need for additional resources for annual program operating needs first. That is not to suggest that facility needs are not requested by the Department. They are sought annually through the capital construction budget, and increasingly in recent years through the operating budget as well. They are consistently a mix of large to very large – Department-wide master plan, campus infrastructure capital renewal, or facility replacement requests, medium and ongoing – "suicide mitigation" projects which appear to be perpetual and interminable, and relatively small – controlled maintenance to keep current facilities updated just enough relative to life safety, security, and accreditation requirements.

The Department's current request for additional beds for "competency services" is a case where the Department is pushing a facility-driven solution that will lead to substantial program build-out. But, in most cases, facility needs are generally not considered or built into program expansion plans and change requests. Facility needs remain afterthoughts relative to constant, incremental program changes, until the point is reached that very large facility needs have to be addressed but money is only available for annual, "band-aid" maintenance projects: converting existing space and adding beds; suicide mitigation; life safety improvements. DHS program priorities do not include or account for an incremental recognition of facility needs, because from the Department's perspective:

- To recognize and fully account for the cost of facilities might endanger a request for policy change and program expansion due to the additional, incremental cost for facilities.

- Facilities can always be addressed after the fact, when they are absolutely necessary for continued client, staff, and public safety and security.

- Facilities will necessarily be funded when it is made clear to budget authorities, through life safety and security failures, that additional money has to be spent on facilities due to "public emergency".

While on the surface it appears to contradict a "program-driven" and "non-facility-centric" approach, a three-phase, $34.2 million facility project request, that begins with a first-year $3.7 million decision, but annualizes to a $62.1 million operating budget increase and program expansion (in today's dollars), is arguably driven by an emphasis on program expansion that may or may not be the best approach for the State on the program side. In this case, the Department is playing poker on its operating build-out by going all in on facility investment that comes in at $3.7 million in a current year supplemental. But that $3.7 million supplemental decision that addresses a public emergency is affordable relative to current budget priorities. Nevertheless, that decision necessarily leads to a three-year capital construction commitment of $34.2 million and a program cost of $62.1 million per year.

Rather than pay $34.2 million for a new or renovated facility in a lump sum, after which the Department might choose to change its mind again about its program needs in the next five to 10 years, the Committee should consider the annual $62.1 million operating budget increase with an additional annual lease payment for its facility costs. Financing a $34.2 million construction project for 20 years at 4.0 percent would cost about $2.5 million per year. Including a 1.0 percent recapitalization (controlled maintenance) set-aside would bring the cost to about $2.9 million per year. Assuming that annual facility maintenance costs are included in the projected operating cost, the annual facility cost – capital construction, financing, and controlled maintenance set-aside only – of $2.9 million would represent 4.4 percent of the total program annual cost of $65.0 million. This would provide a more accurate annual cost of the requested program build-out. It would also require consideration of the program's needs for at least a 20-year period. However, it is possible that the Department has not considered the needs of this "program" (which it describes as a sudden emergency need for the State) for the next 20 years. At this point, the Department is primarily focused on resolving the public emergency need for the short term; the Department has not communicated a long term plan aside from a substantial program build-out. But the Department knows that the next public emergency will allow it to define its next step relative to program change and facility needs.

From the Department's perspective, as it was anecdotally communicated to me in discussions with DFM staff, capital construction and controlled maintenance funding is regarded as generally outside of the Department's control – not something the Department can actively manage and therefore "be responsible for". The Department is entirely dependent and subject to the capriciousness of the economy and General Fund revenue availability and the General Assembly's annual decision-making. This approach leads to a lag in proactively planning for and improving or replacing deteriorated and unsuitable program facilities until the point of building failure; a general approach of "facility funding by crisis"; or, in the case of the current request, using the capital construction process to initiate a new, relatively expensive policy and program build-out.

So, for DFM, controlled maintenance and capital construction funding is entirely reliant or dependent on the annual availability of state funds. Then, DFM is additionally dependent on the Department's policy priorities and its general, low-priority, low-effort, low-accountability, crisis-funding approach to facilities. DFM, as it is currently structured and funded in the Department's relatively large program structure is organizationally unable to proactively manage or guide Department facility needs. It is structurally bound to operate from a reactive position of "hoping" for funding for additional

controlled maintenance and capital construction and it provides day-to-day maintenance to the extent possible within its operations funding.

This reactive stewardship of state resources along with higher-than-average annual spending on controlled maintenance that still provides only a bare minimum to keep facilities functional for ongoing program needs may ultimately come at a higher cost to the State over time. The inefficiency and waste is compounded by what appears to be an otherwise well-functioning facilities management organization that works efficiently with the resources it does receive.

In the issue brief from November 2015, staff recommended the creation of a state asset management enterprise for the financing, construction, and ownership of DHS facilities. Such an entity would function in the role of a commercial property owner and lease buildings and facilities to DHS programs at cost – financing, construction, maintenance – plus the administrative cost of the enterprise. While the recommendation was a large policy step for the State to make regarding financing, construction, and ownership of state buildings, staff believed it was the best recommendation to offer the Committee and the General Assembly related to the issues identified in the brief.

Nevertheless, at a minimum, staff cannot recommend new or additional DHS building projects until facilities management is, at a minimum, direct costed and direct billed by program for actual costs. Additionally, staff recommends a facility management cost line item in each program budget for transparency; DFM appropriations would then be reflected as reappropriated funds payments from each program in the Department.

# APPENDIX A
# RECENT LEGISLATION AFFECTING CAPITAL CONSTRUCTION BUDGET

## 2017 SESSION BILLS

**S.B. 17-172 (SUPPLEMENTAL BILL):** Modifies FY 2016-17 appropriations for capital construction.

**S.B. 17-254 (LONG BILL):** General appropriations act for FY 2017-18. Includes provisions modifying FY 2011-12, FY 2014-15, and FY 2016-17 appropriations for capital construction.

**S.B. 17-262 (HUTF AND CAPITAL CONSTRUCTION FUND TRANSFERS):** Replaces the S.B. 09-228 and H.B. 16-1416 transfers to the Highway Users Tax Fund (HUTF) and the Capital Construction Fund from FY 2016-17 through FY 2019-20. Specifically, makes the following changes:

- In FY 2016-17, reduces the transfer to the HUTF from $158.0 million to $79.0 million.
- In the remaining three years, replaces the current formula with specific dollar amounts, to be transferred on June 30 of the fiscal year, as follows:

| MODIFIED TRANSFERS | | | | |
|---|---|---|---|---|
| | FY 2016-17 | FY 2017-18 | FY 2018-19 | FY 2019-20 |
| HUTF | $79,000,000 | $79,000,000 | $160,000,000 | $160,000,000 |
| Capital Construction | No change | 0 | 60,000,000 | 60,000,000 |

- The bill does not change the transfer amount for Capital Construction in FY 2016-17. Additionally, the bill eliminates the transfer for FY 2017-18, which will be replaced by transfers made in the Capital Construction transfer bill (S.B. 17-263).
- Repeals provisions that relate to the conditional transfer.

**S.B. 17-263 (CAPITAL-RELATED TRANSFERS OF MONEY):** Makes a number of FY 2017-18 transfers to the Capital Construction Fund (CCF) and the Controlled Maintenance Trust Fund (CMTF).

Transfers include:

- $88,695,961 from the General Fund:
- $500,000 from the General Fund Exempt account; and
- $1,000,000 from the State Historical Fund.

Of the $88,695,961 transferred from the General Fund, $19,855,515 million is transferred to the IT Capital Account in the CCF to pay costs associated with capital IT projects.

Also transfers $20,000,000 from the General Fund to the CMTF to replace funds transferred out in FY 2016-17 for executive orders.

**S.B. 17-267 (SUSTAINABILITY OF RURAL COLORADO):** Among other provisions, the bill requires the state to execute lease-purchase agreements for state buildings in increments of up to $500 million per year in FYs 2018-19 through 2021-22 (up to $2 billion in total) to generate funding for transportation and capital construction projects.

- The first $120 million in proceeds must be used for controlled maintenance and capital construction projects and the remaining proceeds for tier 1 transportation projects.
- Of the $120 million for capital construction-related projects, $113.3 million is specified as funding for FY 2017-18 level 1 out-year project costs and levels 2 and 3 controlled maintenance complete project costs.
- The maximum term of the lease-purchase agreements is 20 years and the maximum total annual payment is $150 million.
- Of the annual payment the first $9 million is from the General Fund (or other legal sources designated by the General Assembly), the next $50 million is from funds under the control of the Transportation Commission, and the remaining $91 million is from the General Fund (or other legal sources designated by the General Assembly).

The bill also eliminates state-provided controlled maintenance funding for institution of higher education academic buildings which are solely funded by cash funds (any non-state funds).

## 2018 SESSION BILLS

**S.B. 18-208 (CREATE GOVERNOR'S MANSION MAINTENANCE FUND):** Creates the Governor's Mansion Maintenance Fund, which may be used to fund rental operations, routine maintenance, and controlled maintenance at the mansion. The fund is comprised of monies earned from mansion operations and is subject to annual appropriation. The fund balance may not exceed $500,000 at the close of any fiscal year. The Governor's Office may expend money from the fund for operating costs and routine maintenance and the Department of Personnel may expend money from the fund for controlled maintenance projects.

**S.B. 18-232 (CALCULATION FOR ART IN PUBLIC PLACES REQUIREMENT):** Changes how the art in public places contribution amount is calculated for projects financed through lease-purchase arrangements. Under current law, the calculation is based on 1.0 percent of the estimated construction cost. This bill changes the calculation to 1.0 percent of the state share of the estimated construction cost, which conforms to how the calculation is made for projects financed through a regular appropriation, rather than a lease-purchase arrangement.

**S.B. 18-276 (INCREASE GENERAL FUND RESERVE):** Increases the statutory General Fund reserve requirement to 7.25 percent of appropriations for FY 2018-19 and subsequent years from 6.5 percent. Repeals exclusions from the calculation of the reserve for appropriations for lease-purchase agreements and appropriations for depreciation-lease equivalent payments into the Capital Construction Fund (CCF) and Controlled Maintenance Trust Fund (CMTF).

**H.B. 18-1006 (INFANT NEWBORN SCREENING):** Expands newborn screening for genetic and metabolic diseases, increases access to follow-up services, and creates a funding source for newborn

hearing loss screening. In FY 2018-19, appropriates $1,951,722 total funds to the Department of Public Health and Environment, including $1,862,500 in capital construction appropriations as follow:

- $1,162,500 cash funds from the Newborn Screening and Genetic Counseling Cash Fund for capital construction related to laboratory space expansion and equipment purchase; and
- $700,000 Capital Construction Fund from the Information Technology Capital Account for capital construction related to an information technology system for hearing loss screening. The bill includes an associated transfer of $700,000 General Fund to the Information Technology Capital Account.

**H.B. 18-1170 (SUPPLEMENTAL BILL):** Modifies FY 2017-18 appropriations for capital construction.

**H.B. 18-1322 (LONG BILL):** General appropriations act for FY 2018-19.

**H.B. 18-1340 (TRANSFERS OF MONEY FOR STATE'S INFRASTRUCTURE):** Makes a number of FY 2018-19 transfers to the Capital Construction Fund (CCF) and the Controlled Maintenance Trust Fund (CMTF). Transfers to the CCF total $89,831,610 and include:

- $89,181,610 from the General Fund:
- $500,000 from the General Fund Exempt account; and
- $150,000 from the State Historical Fund.

Of the $89,181,610 transferred from the General Fund, $15,206,760 is transferred to the IT Capital Account in the CCF to pay costs associated with capital IT projects.

Transfers to the CMTF total $30,000,000 to replace funds transferred out in FY 2017-18 for executive orders.

**H.B. 18-1371 (CAPITAL CONSTRUCTION BUDGET ITEMS):** Relocates spending and encumbrance guidelines from the Long Bill capital construction headnotes to the Colorado Revised Statutes. It also codifies spending and encumbrance guidelines for capital projects approved or modified through a supplemental appropriations bill. Prior to the 2017 legislative session, there was a common understanding that a capital project approved or modified through a supplemental appropriations bill was authorized to spend the appropriation for three full fiscal years. However, three years of spending authority is only explicitly included in the Long Bill capital construction headnotes and not in a supplemental appropriations bill. This bill codifies the three-year extension of spending authority for capital projects included in a supplemental appropriations bill.

**H.B. 18-1372 (EXEMPT FUND FROM CAPITAL CONSTRUCTION FUNDING MECHANISM):** Exempts the Regional Center Depreciation Account in the Capital Construction Fund from the set-aside and appropriation requirements established under S.B. 15-211 and H.B. 17-1144. Senate Bill 15-211 created a process to annually set aside an amount equal to the calculated depreciation of a capital asset funded through the capital construction section of the Long Bill. Under current law, if a state department project is paid in whole or part from a cash fund source, the state department is required to calculate the depreciable cost of the project, and, once the depreciation period begins, an amount equal to the calculated depreciation is appropriated to a capital reserve account created within the cash fund through the Long Bill.

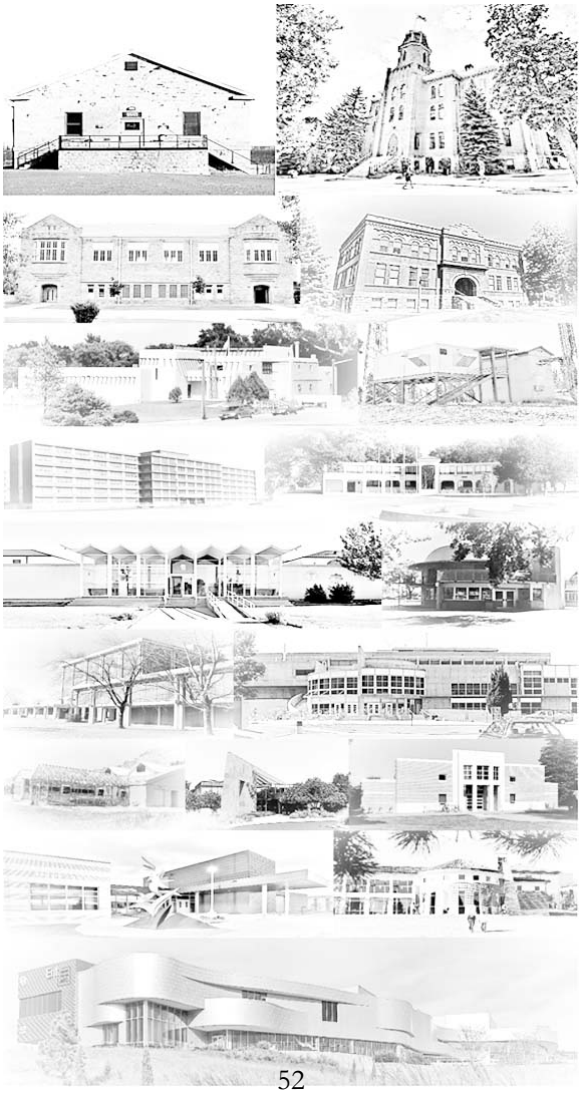
**H.B. 18-1374 (CONTROLLED MAINTENANCE FINANCED ACQUIRED PROPERTY):** Eliminates the eligibility of buildings financed through lease-purchase agreements, such as certificates of participation (COPs), to receive future state funding for controlled maintenance. The bill requires any future legislation authorizing the issuance of COPs to acquire, construct, or renovate state buildings to include a requirement that a state agency or institution of higher education present a plan for funding future controlled maintenance to the Capital Development Committee. The plan must be presented the December or January before the 16th year after the acquisition or substantial completion of a project financed through a lease-purchase agreement. The plan should assess the controlled maintenance needs of the facility for the next 25 years and may include a request for an additional lease-purchase agreement or a request for state funding. An approved plan must be enacted through a bill, other than the Long Bill or a supplemental bill, unless the plan is from a higher education institution to pay for controlled maintenance from cash funds.

# APPENDIX B
# FOOTNOTES AND INFORMATION REQUESTS

There were no Long Bill footnotes or information requests related to Capital Construction.

# C. (CM)

# FUNDING RECOMMENDATIONS



**C.** STATE AGENCIES / INSTITUTIONS OF HIGHER EDUCATION: FUNDING RECOMMENDATIONS FOR FISCAL YEAR 2019/20

Listed on the following pages, by level, reference number, score, project title and dollar amount are the prioritized controlled maintenance project request funding recommendations FY 2019/20 for current-year project requests totaling of **$97,639,988**. These recommendations are submitted as the *state's controlled maintenance budget request* as required by Section 24-30-1303 (1) (t) (II) C.R.S, to the Governor's Office of State Planning and Budgeting and the Capital Development Committee. The Office of the State Architect prepares the prioritized list based on site verification visits to observe the general condition of the agency/institution's building inventory, assess the status of on-going construction projects and visually inspect and evaluate each current-year project request and associated out-year project phase as part of their five-year plan.

The chart below summarizes by priority level, quantity and dollar amount the $97,639,988 of current-year project requests and also lists for further consideration an additional $52,552,929 of associated out-year project request balances by project phase, for a total of **$150,192,917**, (Refer to Section II - D for project details.)

| Priority | Quantity | | Current-year project requests/Out-year project phases | $ Amount | |
|---|---|---|---|---|---|
| Level 1* | 28 | | Current-year project requests | $27,963,348 | |
| | | 12 | Out-year project phases | | $8,714,147 |
| Level 2** | 51 | | Current year project requests | $44,985,485 | |
| | | 28 | Out-year project phases | | $26,380,526 |
| Level 3*** | 31 | | Current-year project requests | $24,691,155 | |
| | | 18 | Out-year project phases | | $17,458,256 |
| Sub Total | **110** | | **Current-year project requests** | **$97,639,988** | |
| | | **58** | **Out-year project phases** | | **$52,552,929** |

***Level 1** incorporates critical projects that are predominantly *life safety and/or loss of use* (the later resulting from equipment/system failure and/or lack of compliance with codes, standards and accreditation requirements) and includes the *Emergency Fund* for unanticipated circumstances.

****Level 2** incorporates projects that are predominantly causing *operational disruptions/energy inefficiencies* and/or *environmental contamination*.

*****Level 3** incorporates projects that predominantly contain differing levels of *deterioration* such as roofs, roads and sidewalks.

**Although the annual controlled maintenance budget request has been comprised of three levels of project priorities intended to address the overall condition of the state's building inventory, various downturns in the economy over the last twenty years have lead to inconsistent and limited funding only for Level 1 and sometimes a portion of Level 2. The result of not having sufficient funds for all three levels annually has caused, for example, roofing projects that were originally categorized in Level 3, to now increase in criticality to Level 2 and eventually Level 1 due to continued deterioration over time.**

| Ref No. | Score | Agency **Project Title, Phase** | Project M# | **CURRENT-YEAR* Project Request** | OUT-YEAR* Project Balance | Cumulative Total of Recommended Projects |
|---|---|---|---|---|---|---|
| **LEVEL 1** | | | | | | |
| 1 | 1 | Office of the State Architect<br>**Emergency Fund** | | **$2,000,000** | $0 | $2,000,000 |
| 1 | 1 | Office of the State Architect<br>**Emergency Fund, (Additional)** | | **$110,216** | $0 | $2,110,216 |
| 2 | 4 | Department of Human Services<br>**Repair/Replace Fire Protection Systems, GYSC and LMYSC, Ph 2 of 3** | 2019-035M18 | **$1,343,338** | $1,110,602 | $3,453,554 |
| 3 | 4 | University of Colorado Boulder<br>**Replace Campus Fire Alarm Control Panels, Ph 2 of 3** | 2019-025M18 | **$1,108,497** | $1,062,739 | $4,562,051 |
| 4 | 5 | Colorado Community College System at Lowry<br>**Upgrade Security Systems, Campus, Ph 2 of 3** | 2019-040M18 | **$516,089** | $509,544 | $5,078,140 |
| 5 | 5 | Colorado School of Mines<br>**Upgrade Fire Alarm Mass Notification System, Ph 2 of 4** | 2019-027M18 | **$671,378** | $880,222 | $5,749,518 |
| 6 | 5 | History Colorado<br>**Fire Mitigation, Georgetown Railway Loop, Area C, Ph 1 of 3** | | **$475,237** | $1,062,674 | $6,224,755 |
| 7 | 5 | Colorado State University<br>**Replacement of Wastewater Treatment Plant, Mountain Campus, Ph 2 of 2** | 2019-031M18 | **$1,845,608** | $0 | $8,070,363 |
| 8 | 5 | Western Colorado University<br>**NE Campus Storm Water Mitigation, Ph 1 of 1** | | **$1,333,477** | $0 | $9,403,840 |
| 9 | 5 | Department of Personnel & Administration - Division of Capital Assets<br>**Refurbish Elevators, 1570 Grant Building, Ph 1 of 1** | | **$714,120** | $0 | $10,117,960 |
| 10 | 5 | Office of the Governor - Office of Information Technology<br>**Replace Microwave Towers, Group E, Ph 1 of 2** | | **$921,419** | $687,009 | $11,039,379 |
| 11 | 6 | Colorado School of Mines<br>**Remediate Campus Fall Hazard, Ph 2 of 3** | 2019-037M18 | **$527,474** | $461,206 | $11,566,853 |
| 12 | 6 | Department of Corrections<br>**Replace Fire Alarm System, SCF, Ph 2 of 2** | 2019-038M18 | **$998,336** | $0 | $12,565,189 |
| 13 | 6 | Department of Human Services<br>**Replace Fire Alarm Control Panels, CMHIP, RVYSC, Ph 1 of 1** | | **$688,966** | $0 | $13,254,155 |
| 14 | 6 | Red Rocks Community College<br>**Install Fire Sprinkler Lines and Upgrade Fire Alarm System, Main Building, Ph 1 of 2** | | **$1,566,978** | $1,447,677 | $14,821,133 |
| 15 | 6 | Department of Personnel & Administration - Division of Capital Assets<br>**Replace Fire Suppression Water Lines, Centennial Building, Ph 1 of 1** | | **$1,623,335** | $0 | $16,444,468 |
| 16 | 6 | Department of Corrections<br>**Replace Fire Alarm System, SCCF, Ph 1 of 1** | | **$1,180,268** | $0 | $17,624,736 |
| 17 | 6 | Colorado State University<br>**Replace Emergency Generator, CSU Police Services Building, Ph 1 of 1** | | **$190,635** | $0 | $17,815,371 |

*Refer to Section II – D: for current, prior and future project / phase details

| Ref No. | Score | Agency **Project Title, Phase** | Project M# | **CURRENT-YEAR* Project Request** | OUT-YEAR* Project Balance | Cumulative Total of Recommended Projects |
|---|---|---|---|---|---|---|
| 18 | 6 | Department of Agriculture - Colorado State Fair<br>**Replace HVAC Systems at Event Center, Ph 1 of 1** | | **$1,527,448** | $0 | $19,342,819 |
| 19 | 8 | Front Range Community College<br>**Replace Chiller #2, Westminster Campus, Ph 1 of 1** | | **$895,427** | $0 | $20,238,246 |
| 20 | 8 | Colorado State University<br>**Replace Domestic Water Line, University Avenue, Ph 1 of 1** | | **$537,676** | $0 | $20,775,922 |
| 21 | 8 | Department of Corrections<br>**Replace Roof, Infirmary, CTCF, Ph 1 of 1** | | **$1,038,141** | $0 | $21,814,063 |
| 22 | 9 | Department of Public Safety<br>**Replace HVAC System, Building 126, Ph 1 of 1** | | **$728,106** | $0 | $22,542,169 |
| 23 | 10 | Pueblo Community College<br>**Replace Roof, Main Building, Southwest Campus, Ph 1 of 2** | | **$864,246** | $634,035 | $23,406,415 |
| 24 | 10 | Department of Education - Colorado School for the Deaf and Blind<br>**Replace Campus Domestic Hot Water System, Ph 1 of 1** | | **$972,421** | $0 | $24,378,836 |
| 25 | 10 | Fort Lewis College<br>**Replace North Campus Heating and Cooling Line, Ph 1 of 2** | | **$1,638,838** | $858,439 | $26,017,674 |
| 26 | 10 | Lamar Community College<br>**Replace Hydronic Piping and Associated Equipment, Bowman, Trustees Buildings, Ph 1 of 1** | | **$425,750** | $0 | $26,443,424 |
| 27 | 10 | Colorado Community College System at Lowry<br>**Improve Indoor Air Quality, HVAC System, Building 753, Ph 1 of 1** | | **$800,359** | $0 | $27,243,783 |
| 28 | 10 | Otero Junior College<br>**Repair/Replace Roofs, Kiva, McBride, and Wheeler Buildings, Ph 1 of 1** | | **$719,565** | $0 | $27,963,348 |
| | | **Level 1** | **Totals:** | **$27,963,348** | $8,714,147 | |

**Cumulative Current-Year Project Requests: $27,963,348**

**Cumulative Out-Year Project Balances: $8,714,147**

*Refer to Section II – D: for current, prior and future project / phase details

| Ref No. | Score | Agency **Project Title, Phase** | Project M# | **CURRENT-YEAR* Project Request** | OUT-YEAR* Project Balance | Cumulative Total of Recommended Projects |
|---|---|---|---|---|---|---|
| **LEVEL 2** | | | | | | |
| 29 | 12 | Department of Corrections<br>**Fire Alarm System Replacement and Fire Suppression Improvements, LCF, Ph 2 of 2** | 2017-039M16 | **$1,092,787** | $0 | $29,056,135 |
| 30 | 12 | Lamar Community College<br>**Upgrade Building Door Access Control and Campus Safety, Ph 1 of 2** | | **$1,301,245** | $1,278,283 | $30,357,380 |
| 31 | 12 | Department of Corrections<br>**Improve Perimeter Security, DRDC and DWCF, Ph 2 of 2** | 2015-136M16 | **$1,205,969** | $0 | $31,563,349 |
| 32 | 12 | Colorado School of Mines<br>**Replace Primary Power Transformers, Five Buildings, Ph 1 of 1** | | **$737,163** | $0 | $32,300,512 |
| 33 | 12 | Colorado State University<br>**Replace Multiple Primary Electric Switchgears, Main Campus, Ph 1 of 1** | | **$588,904** | $0 | $32,889,416 |
| 34 | 12 | Colorado Mesa University<br>**Upgrade HVAC and Control Systems, Lowell Heiny Hall, Ph 1 of 1** | | **$556,973** | $0 | $33,446,389 |
| 35 | 12 | Department of Corrections<br>**Replace Deaeration Tank, SCF, Ph 1 of 1** | | **$1,457,417** | $0 | $34,903,806 |
| 36 | 12 | Colorado Northwestern Community College<br>**Refurbish Hydronic Heat System, Johnson Building, Rangely Campus, Ph 1 of 1** | | **$826,045** | $0 | $35,729,851 |
| 37 | 12 | Adams State University<br>**Replace Campus Boilers, Five Buildings, Ph 1 of 1** | | **$1,037,625** | $0 | $36,767,476 |
| 38 | 12 | University of Colorado Colorado Springs<br>**Replace Chillers, Engineering Building, Ph 1 of 1** | | **$870,802** | $0 | $37,638,278 |
| 39 | 12 | University of Northern Colorado<br>**Replace Chiller, McKee Hall, Ph 1 of 1** | | **$489,672** | $0 | $38,127,950 |
| 40 | 12 | Department of Human Services<br>**Refurbish HVAC Systems, B Building, CMHIFL, Ph 1 of 2** | | **$1,291,687** | $888,179 | $39,419,637 |
| 41 | 12 | Trinidad State Junior College<br>**Upgrade HVAC Air Quality and Building Safety, Alamosa Campus, Ph 1 of 2** | | **$1,281,211** | $1,163,177 | $40,700,848 |
| 42 | 12 | Arapahoe Community College<br>**Replace HVAC Primary Equipment, Main Building, Ph 1 of 3** | | **$1,692,460** | $2,791,612 | $42,393,308 |
| 43 | 12 | Northeastern Junior College<br>**Repair/Upgrade Emergency Vehicle Access, Ph 1 of 1** | | **$522,638** | $0 | $42,915,946 |
| 44 | 12 | Department of Military and Veterans Affairs<br>**Upgrade Restrooms for Code Compliance, 3650th Readiness Center, Ph 1 of 1** | | **$397,370** | $0 | $43,313,316 |
| 45 | 12 | Pikes Peak Community College<br>**Replace Sewer Vent Pipes and Upgrade Restrooms, Centennial Campus, Ph 1 of 2** | | **$1,252,375** | $545,235 | $44,565,691 |

*Refer to Section II – D: for current, prior and future project / phase details

| Ref No. | Score | Agency **Project Title, Phase** | Project M# | **CURRENT-YEAR* Project Request** | OUT-YEAR* Project Balance | Cumulative Total of Recommended Projects |
|---|---|---|---|---|---|---|
| 46 | 12 | Colorado State University<br>**Modernize Elevators, Atmospheric Science and Eddy Hall, Ph 1 of 1** | | **$281,930** | $0 | $44,847,621 |
| 47 | 12 | Colorado State University - Pueblo<br>**Repair Building Envelope, Hasan School of Business, Ph 1 of 1** | | **$720,720** | $0 | $45,568,341 |
| 48 | 14 | Department of Corrections<br>**Replace Electronic Door Security System, DWCF, Ph 1 of 1** | | **$1,998,638** | $0 | $47,566,979 |
| 49 | 14 | Department of Personnel & Administration - 1881 Pierce<br>**Replace Main Electrical Switch Gear and Motor Control Center, Ph 1 of 1** | | **$847,652** | $0 | $48,414,631 |
| 50 | 14 | Department of Corrections<br>**Improve Accessibility, FCF, Ph 1 of 5** | | **$1,978,510** | $6,101,414 | $50,393,141 |
| 51 | 14 | Colorado State University - Pueblo<br>**Replace Campus Water Lines, Ph 1 of 3** | | **$900,680** | $1,800,000 | $51,293,821 |
| 52 | 14 | Colorado State University<br>**Replace ARDEC Farm Bridge, Ph 1 of 1** | | **$349,872** | $0 | $51,643,693 |
| 53 | 14 | Colorado School of Mines<br>**Replace Temperature Controls, Lakes Library, Ph 1 of 1** | | **$339,744** | $0 | $51,983,437 |
| 54 | 14 | Morgan Community College<br>**Replace RTUs and Upgrade Controls, Aspen, Elm, and Spruce Halls, Ph 1 of 1** | | **$796,400** | $0 | $52,779,837 |
| 55 | 14 | University of Colorado Boulder<br>**Upgrade Campus HVAC Compressed Air Systems, Ph 1 of 1** | | **$1,054,424** | $0 | $53,834,261 |
| 56 | 14 | University of Colorado Denver<br>**Improve Heating System, Building 500, Ph 1 of 5** | | **$727,427** | $3,064,926 | $54,561,688 |
| 57 | 15 | Department of Personnel & Administration - State Capitol Building<br>**Replace Short Tunnel Roof, Capitol, Ph 1 of 1** | | **$1,721,273** | $0 | $56,282,961 |
| 58 | 15 | University of Colorado Colorado Springs<br>**Refurbish Campus Elevators, 6 Buildings, Ph 1 of 3** | | **$228,196** | $787,354 | $56,511,157 |
| 59 | 16 | Community College of Aurora<br>**Upgrade Site Security, Ph 1 of 1** | | **$1,294,119** | $0 | $57,805,276 |
| 60 | 16 | Department of Corrections<br>**Improve Door Security, Cellhouse 3, CTCF, Ph 1 of 1** | | **$1,202,622** | $0 | $59,007,898 |
| 61 | 16 | Department of Human Services<br>**Refurbish HVAC and Mechanical Equipment, ZPYSC, PYSC, SCYSC, Ph 1 of 2** | | **$1,177,135** | $901,745 | $60,185,033 |
| 62 | 16 | Colorado Community College System at Lowry<br>**Replace HVAC Equipment, Building 999, Ph 1 of 1** | | **$980,743** | $0 | $61,165,776 |
| 63 | 16 | Red Rocks Community College<br>**Refurbish West Wing Elevator, Lakewood Campus, Ph 1 of 1** | | **$210,410** | $0 | $61,376,186 |

*Refer to Section II – D: for current, prior and future project / phase details

| Ref No. | Score | Agency **Project Title, Phase** | Project M# | **CURRENT-YEAR* Project Request** | OUT-YEAR* Project Balance | Cumulative Total of Recommended Projects |
|---|---|---|---|---|---|---|
| 64 | 16 | Front Range Community College<br>**Replace Harmony Library Roof, Larimer Campus, Ph 1 of 1** | | **$445,200** | $0 | $61,821,386 |
| 65 | 16 | Colorado State University - Pueblo<br>**Replace Roof, Buell Communication Center, Ph 1 of 1** | | **$609,743** | $0 | $62,431,129 |
| 66 | 18 | University of Northern Colorado<br>**Replace Windows, Frasier Hall, Ph 1 of 2** | | **$1,141,686** | $595,196 | $63,572,815 |
| 67 | 18 | Department of Human Services<br>**Refurbish Ash Conveyor System, Heat Plant, CMHIP, Ph 1 of 2** | | **$1,451,135** | $1,356,196 | $65,023,950 |
| 68 | 18 | Department of Military and Veterans Affairs<br>**Replace Roof and Fire Alarm Systems, BAFB Building 1500, Ph 1 of 1** | | **$610,895** | $0 | $65,634,845 |
| 69 | 18 | Department of Public Health and Environment<br>**Replace Mechanical System, Laboratory Building, Ph 1 of 2** | | **$1,321,089** | $1,324,004 | $66,955,934 |
| 70 | 18 | Colorado State University<br>**Replace Roof, B Wing, Engineering Building, Ph 1 of 1** | | **$474,307** | $0 | $67,430,241 |
| 71 | 18 | Department of Corrections<br>**Replace Roof, Administration Building, CTCF, Ph 1 of 1** | | **$887,220** | $0 | $68,317,461 |
| 72 | 18 | Department of Human Services<br>**Replace Roofs, Five Buildings, CMHIFL, Ph 1 of 2** | | **$906,863** | $1,119,798 | $69,224,324 |
| 73 | 20 | Colorado Mesa University<br>**Replace Roof, Wubben/Science Building, Ph 1 of 1** | | **$286,643** | $0 | $69,510,967 |
| 74 | 20 | History Colorado<br>**Replace Roofs, Santa Fe Trail Museum and Baca House, Ph 1 of 1** | | **$198,941** | $0 | $69,709,908 |
| 75 | 20 | Department of Human Services<br>**Replace Hydronic Valves, Southern District, Ph 1 of 2** | | **$720,887** | $859,804 | $70,430,795 |
| 76 | 20 | Colorado Northwestern Community College<br>**Accessibility Improvements, Craig Campus, Ph 1 of 1** | | **$640,750** | $0 | $71,071,545 |
| 77 | 20 | Northeastern Junior College<br>**Accessibility Improvements, Two Buildings, Ph 1 of 2** | | **$387,200** | $701,250 | $71,458,745 |
| 78 | 20 | Colorado State University<br>**Refurbish Water Wells, Pumps, Ditches, ARDEC, Ph 1 of 1** | | **$914,000** | $0 | $72,372,745 |
| 79 | 20 | Department of Human Services<br>**Refurbish HVAC Systems, Three Youth Services Sites, Ph 1 of 3** | | **$576,088** | $1,102,353 | $72,948,833 |
| | | Level 2 | Totals: | **$44,985,485** | $26,380,526 | |

**Cumulative Current-Year Project Requests: $72,948,833**

**Cumulative Out-Year Project Balances: $35,094,673**

*Refer to Section II – D: for current, prior and future project / phase details

| Ref No. | Score | Agency **Project Title, Phase** | Project M# | **CURRENT-YEAR* Project Request** | OUT-YEAR* Project Balance | Cumulative Total of Recommended Projects |
|---|---|---|---|---|---|---|
| **LEVEL 3** | | | | | | |
| 80 | 21 | Colorado State University<br>**Replace Electric Service, Foothills Campus, Ph 1 of 1** | | **$1,273,655** | $0 | $74,222,488 |
| 81 | 21 | Department of Human Services<br>**Refurbish Secondary and Emergency Electrical Systems, Tier 1, CMHIP, Ph 1 of 3** | | **$1,957,543** | $2,611,543 | $76,180,031 |
| 82 | 21 | Colorado State University - Pueblo<br>**Refurbish Elevators, Three Buildings, Ph 1 of 1** | | **$567,986** | $0 | $76,748,017 |
| 83 | 21 | Department of Human Services<br>**Replace Patient Buildings Windows, CMHIP, Ph 1 of 2** | | **$1,019,810** | $1,019,810 | $77,767,827 |
| 84 | 21 | Department of Military and Veterans Affairs<br>**Replace Pavement and Upgrade Security Lighting, BAFB Aviation Readiness Center, Ph 1 of 2** | | **$745,630** | $627,990 | $78,513,457 |
| 85 | 21 | Fort Lewis College<br>**Replace Roof, Aquatic Center, Ph 1 of 1** | | **$598,656** | $0 | $79,112,113 |
| 86 | 21 | Department of Human Services<br>**Replace Roofs, DYS, Three Sites, Ph 1 of 2** | | **$1,327,128** | $1,457,026 | $80,439,241 |
| 87 | 24 | Colorado State University<br>**Upgrade Fire Alarm Voice Notification System, Three Buildings, Ph 1 of 1** | | **$675,319** | $0 | $81,114,560 |
| 88 | 24 | Pikes Peak Community College<br>**Improve Electrical Infrastructure, Rampart Range Campus, Ph 1 of 1** | | **$269,124** | $0 | $81,383,684 |
| 89 | 24 | Department of Personnel & Administration - Division of Capital Assets<br>**Refurbish Freight Elevator, Centennial Building, Ph 1 of 1** | | **$476,300** | $0 | $81,859,984 |
| 90 | 24 | University of Colorado Boulder<br>**Refurbish Elevators, Six Buildings, Ph 1 of 3** | | **$1,391,250** | $3,170,250 | $83,251,234 |
| 91 | 24 | Community College of Aurora<br>**Replace HVAC, Student Center, Ph 1 of 1** | | **$335,458** | $0 | $83,586,692 |
| 92 | 24 | Colorado Community College System at Lowry<br>**Upgrade HVAC System, Building 905, Ph 1 of 2** | | **$1,024,445** | $967,742 | $84,611,137 |
| 93 | 24 | Department of Local Affairs - Fort Lyon<br>**Refurbish HVAC System, Three Buildings, Ph 1 of 1** | | **$802,352** | $0 | $85,413,489 |
| 94 | 24 | University of Colorado Denver<br>**Refurbish Bathrooms, Building 500, Ph 1 of 3** | | **$884,609** | $1,711,555 | $86,298,098 |
| 95 | 24 | Department of Human Services<br>**Replace Gym Floors, DYS, Ph 1 of 2** | | **$1,699,597** | $472,278 | $87,997,695 |
| 96 | 24 | Department of Personnel & Administration - Division of Capital Assets<br>**Upgrade/Replace HVAC Systems, 690 and 700 Kipling, Ph 1 of 2** | | **$1,303,667** | $1,051,268 | $89,301,362 |
| 97 | 24 | Colorado Northwestern Community College<br>**Replace Roof, Hefley Building, Rangely Campus, Ph 1 of 1** | | **$281,218** | $0 | $89,582,580 |
| 98 | 24 | University of Northern Colorado<br>**Replace Roof, Arts Annex, Ross, and Skinner, Ph 1 of 1** | | **$304,260** | $0 | $89,886,840 |

*Refer to Section II – D: for current, prior and future project / phase details

| Ref No. | Score | Agency **Project Title, Phase** | Project M# | **CURRENT-YEAR* Project Request** | OUT-YEAR* Project Balance | Cumulative Total of Recommended Projects |
|---|---|---|---|---|---|---|
| 99 | 27 | Colorado State University<br>**Upgrade Campus Exterior Lighting, Ph 1 of 1** | | **$489,275** | $0 | $90,376,115 |
| 100 | 28 | Colorado Mesa University<br>**Refurbish HVAC and Control Systems, Moss Performing Arts, Ph 1 of 1** | | **$1,244,628** | $0 | $91,620,743 |
| 101 | 28 | Office of the Governor - Office of Information Technology<br>**Replace Microwave Communications Site Shelters, Ph 1 of 2** | | **$1,043,767** | $876,735 | $92,664,510 |
| 102 | 30 | University of Colorado Colorado Springs<br>**Replace AHU and Return Air System, Columbine Hall, Ph 1 of 1** | | **$484,473** | $0 | $93,148,983 |
| 103 | 36 | Department of Human Services<br>**Replace Flooring, Five Buildings, CMHIFL, Ph 1 of 3** | | **$878,779** | $986,886 | $94,027,762 |
| 104 | 36 | Department of Education - Colorado School for the Deaf and Blind<br>**Repair Front Steps, Administration Building, Ph 1 of 1** | | **$412,548** | $0 | $94,440,310 |
| 105 | 36 | Front Range Community College<br>**Replace Roof and RTUs, Challenger Point Building, Larimer Campus, Ph 1 of 1** | | **$488,125** | $0 | $94,928,435 |
| 106 | 36 | Department of Local Affairs - Fort Lyon<br>**Refurbish Water Tower, Ph 1 of 1** | | **$134,694** | $0 | $95,063,129 |
| 107 | 42 | Department of Human Services<br>**Upgrade Interiors Group Home, PRC, DC, Ph 1 of 3** | | **$1,236,417** | $2,388,041 | $96,299,546 |
| 108 | 42 | University of Colorado Colorado Springs<br>**Replace Roof, Columbine Hall, Ph 1 of 2** | | **$312,519** | $117,132 | $96,612,065 |
| 109 | 45 | Colorado Mesa University<br>**Improve Building Envelope, AEC and Wubben/Science Buildings, Ph 1 of 1** | | **$417,855** | $0 | $97,029,920 |
| 110 | 45 | History Colorado<br>**Paint High Bridge, Georgetown Mining and Railroad Park, Ph 1 of 1** | | **$610,068** | $0 | $97,639,988 |
| | | | **Level 3 Totals:** | **$24,691,155** | $17,458,256 | |

**Cumulative Current-Year Project Requests: $97,639,988**

**Cumulative Out-Year Project Balances: $52,552,929**

**Grand Total of Current-Year Project Requests and Cumulative Out-Year Project Balances: $150,192,917**

*Refer to Section II – D: for current, prior and future project / phase details

# Issue 3: DHS Facilities

Capital construction policymakers perceive that the condition of Department of Human Services (DHS) facilities and properties warrants exceptional attention. The new, statewide planning function in the Office of the State Architect (OSA) is expected to initially focus its efforts on DHS facility needs and make recommendations beginning in FY 2017-18. Related issues of current state funding limitations, alternative funding or financing options, and ongoing maintenance funding and stewardship of DHS properties should be addressed alongside OSA planning efforts before the State invests in substantial DHS facility upgrades and improvements.

## SUMMARY:

- Data analysis suggests that DHS buildings are generally older and more deteriorated than those in other state agencies and the State is spending more on controlled maintenance for DHS facilities relative to other state buildings. Facility visits, building system visual reviews, and other anecdotal information likewise suggest that DHS facilities overall need to be upgraded.

- The DHS facilities management unit, DFM, appears to do a good job of property management with the resources provided, but does not provide asset management and is housed within a program-intensive department in which facility needs are generally an afterthought and not part of program change planning.

- The current facilities management structure does not transparently convey cost information to budget authorities regarding actual program facility costs and is not conducive to long term stewardship of state assets.

- Real property asset management is a systematic process of deploying, operating, maintaining, upgrading, and disposing of assets cost-effectively over every year of an asset's lifecycle.

- An asset management model could provide transparent cost information through actual and planned lease payments and property management fees to better guide budget authorities on facility cost decisions related to DHS program growth, reduction, or change.

- A properly structured asset management entity can provide the most efficient and effective method for maintaining facilities over the short term and the long term and could provide independent controlled maintenance funding through properly-costed lease rates paid in the operating budget.

## RECOMMENDATION:

**Staff recommends that the Committee pursue legislation to create a State Asset Management Trust enterprise to manage all Department of Human Services real property assets.**

## DISCUSSION:

**Overview**

Last year, the Department of Human Services (DHS or Department) requested a $5.1 million master plan to be executed in three phases beginning in FY 2015-16. While the DHS request was not funded, it was generally understood by capital construction policymakers that DHS facilities and properties are in a condition that warrants exceptional attention compared to other state agencies.

Additionally, a statewide planning function was added to the Office of the State Architect (OSA) to address state agency real property and facility planning on an ongoing basis. The statewide planning function was added to provide pre-appropriation due diligence of state agency capital construction project requests and to provide more rigorous and ongoing planning for future state agency building needs. It is expected that statewide planning will initially focus much of its efforts on DHS facility needs in response to the generally recognized need.

It is expected that statewide planning will likely make recommendations for DHS facilities beginning in the next budget year, FY 2017-18. It is conceivable that those recommendations may include the renovation or replacement of existing facilities over a period of time extending over several years but beginning as early as FY 2017-18.

Given the current governing challenge of prioritizing and apportioning adequate state funding for controlled maintenance and capital construction, **it is appropriate and necessary to consider alternative governing models that might provide achievable and reasonable acquisition and payment structures for new or upgraded facilities and improve stewardship of current and future properties and facilities.**

**Condition of DHS Facilities – Facility Condition Index**

The State Architect uses the facility condition index (FCI) as a reasonable indicator of building condition. The FCI is the average condition of all building components. A new building has an FCI rating of 100 percent and the State Architect recommends maintaining buildings at an FCI of 85 percent. The following table was included in a JBC staff briefing from 2013, comparing FCI across state agencies.

| **Facility Condition Index Comparison (November 2012 data)** | | | |
|---|---|---|---|
| | | **Percent Bldgs. w/FCI below:** | |
| | **Buildings** | **<70%** | **<50%** |
| Agriculture | 62 | 32.0% | 10.0% |
| Corrections | 749 | 38.0% | 12.0% |
| Education | 18 | 17.0% | 6.0% |
| Governor - OIT | 60 | 32.0% | 2.0% |
| Higher Education | 1,772 | 32.0% | 14.0% |

| **Facility Condition Index Comparison (November 2012 data)** | | Percent Bldgs. w/FCI below: | |
|---|---|---|---|
| | **Buildings** | **<70%** | **<50%** |
| Human Services | 337 | 51.0% | 11.0% |
| Labor and Employment | 3 | 0.0% | 0.0% |
| Military and Veterans Affairs | 87 | 8.0% | 2.0% |
| Personnel - Capitol Complex | 20 | 70.0% | 10.0% |
| Public Health and Environment | 2 | 0.0% | 0.0% |
| Public Safety | 45 | 11.0% | 0.0% |
| Revenue | 15 | 0.0% | 0.0% |
| **Total** | **3,170** | **35.0%** | **12.0%** |

Source: JBC Staff Capital Construction briefing document, November 7, 2013.

The comparison suggests that DHS has more of its 337 buildings below 70.0 percent FCI than all other agencies except for the Department of Personnel – Capitol Complex, which has a significantly smaller inventory of 20 buildings. However, the OSA does not use an FCI comparison across agencies because agencies self-report and while methodology is objective, the evaluation process may vary by about ten percent higher or lower based on the evaluator.

Staff requested additional information from DHS on their buildings and found that only 283 of the 337 buildings, or 83.5 percent, have an FCI rating. The OSA reports that less than 15 percent of DHS buildings have received an FCI audit in the last five years. The OSA reports that typically, DHS will expend the effort of an FCI audit for a building in need of controlled maintenance. The Department focuses its staff time and resources on maintenance rather than on additional administrative tracking.

DHS self-reports an average FCI across all buildings at 66.6 percent. Staff similarly calculated a 64.0 percent average and 65.3 percent median FCI rating for Department buildings based on data provided. On a square footage basis rather than by building, staff calculated an average FCI of 67.7 percent. **While it may be a reasonable general indicator, due to the large number of DHS buildings, the number of buildings lacking an FCI rating, and the small percentage audited in the last five years, staff questions the degree of accuracy provided by the FCI measure as an objective and specific evaluation of the condition of Department buildings.**

**Facility Valuation Trend Comparison**

The OSA reports annually on state agency building space measured in gross square feet (GSF). Additionally, the OSA uses the State's Risk Management Program's current insured replacement value (CRV) as its standard measure of building value. While this measure does not capture *market value*[1], it reduces the administrative cost of annually establishing a standard value

[1] General market value indicators can be estimated based on type of building and square footage in a given location. However, in order to accurately determine market value, assessments of the condition of building systems would need to be incorporated. For accuracy, a *market value* assessment would require the equivalent of a professional real estate appraisal on an ongoing basis for all buildings in the State.

measure across all buildings in the State. Additionally, it uses a generally accepted value determined by an interested but independent third party, reducing concerns of uneven or subjective value judgements or disagreements over valuation methodology by the OSA. The following tables compare Department changes in GSF and CRV to other state agencies and the state average.

| **Department of Human Services 10-year GSF Trend and Comparison (millions)** | | | | | | |
|---|---|---|---|---|---|---|
| | **Human Services** | **Corrections** | **Higher Education** | **Agriculture (low)** | **CDPHE (high)** | **All State-funded Buildings** |
| FY 2014-15 | 3.48 | 6.45 | 30.94 | 0.88 | 0.11 | 46.33 |
| FY 2013-14 | 3.47 | 6.54 | 30.17 | 0.83 | 0.11 | 44.26 |
| FY 2012-13 | 3.51 | 6.97 | 29.52 | 0.83 | 0.09 | 43.88 |
| FY 2011-12 | 3.51 | 7.12 | 28.89 | 0.83 | 0.09 | 43.31 |
| FY 2010-11 | 3.51 | 7.13 | 28.31 | 0.83 | 0.09 | 42.68 |
| FY 2009-10 | 3.28 | 6.60 | 27.81 | 0.83 | 0.09 | 41.60 |
| FY 2008-09 | 3.28 | 6.60 | 27.28 | 0.78 | 0.09 | 41.03 |
| FY 2007-08 | 3.28 | 6.58 | 26.65 | 0.78 | 0.09 | 40.42 |
| FY 2006-07 | 3.31 | 6.70 | 25.83 | 0.78 | 0.09 | 39.76 |
| FY 2005-06 | 3.31 | 6.58 | 25.29 | 0.78 | 0.09 | 39.06 |
| FY 2004-05 | 3.31 | 6.54 | 24.45 | 0.78 | 0.09 | 38.15 |
| 10-year Change | 5.4% | (1.4%) | 26.5% | 12.2% | 28.0% | 21.4% |
| 10-year Average | 0.5% | (0.1%) | 2.7% | 1.2% | 2.8% | 2.1% |

| **Department of Human Services 10-year CRV Trend and Comparison (millions)** | | | | | | |
|---|---|---|---|---|---|---|
| | **Human Services** | **Corrections** | **Higher Education** | **Agriculture (low)** | **CDPHE (high)** | **All State-funded Buildings** |
| FY 2014-15 | $670.8 | $1,348.9 | $7,712.3 | $87.8 | $52.2 | $10,936.0 |
| FY 2013-14 | 693.7 | 1,371.6 | 7,298.7 | 81.7 | 44.7 | 10,223.9 |
| FY 2012-13 | 743.7 | 1,361.8 | 6,936.8 | 81.7 | 35.9 | 9,924.7 |
| FY 2011-12 | 640.2 | 1,210.6 | 6,522.2 | 81.7 | 35.9 | 9,228.1 |
| FY 2010-11 | 638.5 | 1,211.6 | 5,923.6 | 81.6 | 27.9 | 8,603.5 |
| FY 2009-10 | 580.1 | 1,073.9 | 5,925.7 | 81.7 | 27.7 | 8,453.9 |
| FY 2008-09 | 538.1 | 938.8 | 5,346.5 | 77.1 | 25.3 | 7,622.8 |
| FY 2007-08 | 540.1 | 919.3 | 4,938.4 | 76.7 | 15.6 | 7,186.5 |
| FY 2006-07 | 557.3 | 931.5 | 4,488.9 | 76.7 | 15.6 | 6,769.2 |
| FY 2005-06 | 574.2 | 930.5 | 4,376.2 | 70.6 | 14.4 | 6,662.4 |
| FY 2004-05 | $523.1 | $919.3 | $3,874.9 | $70.6 | $0 | $6,037.4 |
| 10-year Change | 28.2% | 46.7% | 99.0% | 24.4% | 262.8% | 81.1% |
| 10-year Average | 2.8% | 4.7% | 9.9% | 2.4% | 26.3% | 8.1% |

The OSA takes the current replacement value divided by the gross square footage (CRV/GSF) to arrive at a current replacement value per square foot by agency. Holding GSF steady, this value will go up over time based on real property appreciation and inflation; and likewise, this value will go down over time with building deterioration. Given the use of insured replacement value, the total statewide value, state agency subtotal value, or specific building values might vary by other valuation methods. However, an agency-to-agency or agency-to-statewide comparison should give an accurate relative value. Additionally, the use of rates of change over time will provide an accurate comparison of change in valuation figures by state agency. The following tables compare Department change in CRV/GSF to other state agencies and the state average.

**Department of Human Services 10-year CRV/GSF Trend and Comparison**

| | Human Services | Corrections | Higher Education | Agriculture (low) | CDPHE (high) | All State-funded Buildings |
|---|---|---|---|---|---|---|
| FY 2014-15 | $192.61 | $209.18 | $249.26 | $99.77 | $463.51 | $236.04 |
| FY 2013-14 | 199.81 | 209.64 | 241.94 | 98.53 | 399.15 | 231.01 |
| FY 2012-13 | 211.89 | 195.30 | 235.02 | 98.72 | 379.78 | 226.19 |
| FY 2011-12 | 182.38 | 170.02 | 225.74 | 98.72 | 379.78 | 213.09 |
| FY 2010-11 | 181.90 | 170.01 | 209.23 | 98.68 | 316.50 | 201.58 |
| FY 2009-10 | 177.07 | 162.75 | 213.10 | 98.53 | 314.23 | 203.20 |
| FY 2008-09 | 164.25 | 142.19 | 196.01 | 98.35 | 287.93 | 185.79 |
| FY 2007-08 | 164.61 | 139.73 | 185.29 | 97.95 | 177.39 | 177.80 |
| FY 2006-07 | 168.19 | 139.01 | 173.78 | 97.95 | 177.39 | 170.24 |
| FY 2005-06 | 173.26 | 141.43 | 173.07 | 90.01 | 163.52 | 170.58 |
| FY 2004-05 | $158.23 | $140.64 | $158.46 | $90.01 | $0.00 | $158.23 |
| 10-year Change | 21.7% | 48.7% | 57.3% | 10.8% | 183.5% | 49.2% |
| 10-year Average | 2.2% | 4.9% | 5.7% | 1.1% | 18.3% | 4.9% |

Since FY 2004-05, the Department's insured replacement value per square foot (CRV/GSF) has increased 21.7 percent, or 2.2 percent per year. In comparison, the statewide CRV/GSF for all state buildings increased 49.2 percent, or 4.9 percent per year. The State average CRV/GSF measure is 22.7 percent higher than the Department's over that 10-year period although both measures were valued equally at $158.23 in FY 2004-05. Additionally, in comparison, Corrections experienced a 4.9 percent annual average increase, matching the State average, and Higher Education experienced a 5.7 percent annual average increase.

Excluding the institutions of higher education, DHS has the second largest presence in building space, after Corrections. Additionally, DHS serves several different programs, including behavioral and mental health, developmentally disabled, youth corrections, and veterans' community living centers, that require 24-7 client care and facility operation, similar to the programmatically more singular Department of Corrections. DHS institutional programs include a forensic incarceration facility that requires similar security needs to the standard Department of Corrections facility while handling additional, specialized mental and behavioral health requirements. So while the Departments of Human Services and Corrections are similar in their institutional facility needs, the Department of Human Services is responsible for services and

programs that are more diverse in the client communities served and whose needs are just as critical in terms of providing adequate client, staff, and public safety and security.

**The current replacement value per square foot comparison suggests that DHS buildings have not kept pace with other building- or facility-intensive state agencies and with the statewide average on the basis of this measure.**

### Controlled Maintenance Trend Comparison

The following tables compare the Department's controlled maintenance appropriations and CM to CRV ratio to other state agencies and the State average.

**Department of Human Services 12-year Controlled Maintenance Trend and Comparison**

| | Human Services | Corrections | Higher Education | Agriculture (low) | CDPHE (high) | All State-funded Buildings |
|---|---|---|---|---|---|---|
| FY 2015-16 | $1,672,756 | $2,708,075 | $10,250,453 | $0 | $0 | $19,195,021 |
| FY 2014-15 | 4,814,489 | 3,558,036 | 26,809,180 | 992,325 | 323,200 | 45,227,361 |
| FY 2013-14 | 4,522,711 | 5,697,063 | 26,078,178 | 988,738 | 0 | 42,926,689 |
| FY 2012-13 | 2,766,814 | 3,330,583 | 19,528,102 | 709,680 | 0 | 29,087,933 |
| FY 2011-12 | 1,495,808 | 1,822,167 | 2,510,461 | 0 | 0 | 8,418,297 |
| FY 2010-11 | 1,202,511 | 1,712,167 | 3,173,381 | 0 | 0 | 8,129,588 |
| FY 2009-10 | 3,065,905 | 3,419,032 | 12,302,365 | 709,680 | 184,089 | 22,235,321 |
| FY 2008-09 | 3,029,959 | 4,557,407 | 10,749,579 | 1,754,112 | 0 | 24,087,798 |
| FY 2007-08 | 5,008,230 | 5,046,160 | 27,901,510 | 1,853,137 | 0 | 49,957,102 |
| FY 2006-07 | 5,429,689 | 5,900,720 | 28,020,164 | 2,109,681 | 377,300 | 49,005,632 |
| FY 2005-06 | 3,679,382 | 3,312,530 | 9,944,028 | 750,000 | 0 | 20,835,292 |
| FY 2004-05 | 0 | 0 | 0 | 0 | n/a | 0 |
| **12-year Average** | **$3,057,355** | **$3,421,995** | **$14,772,283** | **$822,279** | **$80,417** | **$26,592,170** |

**Department of Human Services 10-year CM/CRV Trend and Comparison**

| | Human Services | Corrections | Higher Education | Agriculture | CDPHE | All State-funded Buildings |
|---|---|---|---|---|---|---|
| FY 2014-15 | 0.72% | 0.26% | 0.35% | 1.13% | 0.62% | 0.41% |
| FY 2013-14 | 0.65% | 0.42% | 0.36% | 1.21% | 0.00% | 0.42% |
| FY 2012-13 | 0.37% | 0.24% | 0.28% | 0.87% | 0.00% | 0.29% |
| FY 2011-12 | 0.23% | 0.15% | 0.04% | 0.00% | 0.00% | 0.09% |
| FY 2010-11 | 0.19% | 0.14% | 0.05% | 0.00% | 0.00% | 0.09% |
| FY 2009-10 | 0.53% | 0.32% | 0.21% | 0.87% | 0.67% | 0.26% |
| FY 2008-09 | 0.56% | 0.49% | 0.20% | 2.28% | 0.00% | 0.32% |
| FY 2007-08 | 0.93% | 0.55% | 0.56% | 2.41% | 0.00% | 0.70% |
| FY 2006-07 | 0.97% | 0.63% | 0.62% | 2.75% | 2.42% | 0.72% |
| FY 2005-06 | 0.64% | 0.36% | 0.23% | 1.06% | 0.00% | 0.31% |
| **10-year Average** | **0.58%** | **0.36%** | **0.29%** | **1.26%** | **0.37%** | **0.36%** |

In FY 2014-15, $45.2 million in controlled maintenance was appropriated for a statewide total CRV of $10.9 billion, equal to 0.41 percent of current replacement value. Averaged over the ten-year period, statewide appropriations for controlled maintenance to CRV ratio for all State buildings was 0.36 percent. In comparison, the Department's CM/CRV ratio for FY 2014-15 was 0.72 percent; its 10-year average CM/CRV ratio was 0.58 percent. Similarly, when compared to Corrections, the Department of Human Services nearly doubles the Department of Corrections' CM/CRV ratio when compared in individual years or averaged across longer periods.

When comparing controlled maintenance funding by state agency and by the statewide total, the Department generally shows a higher CM/CRV ratio. **The Department has received a greater share of controlled maintenance dollars relative to the statewide average.**

The State Architect recommends that annual controlled maintenance (CM) be funded at a minimum of 1.0 percent of current replacement value. It would appear that the closer an agency gets to the 1.0 percent recommendation, the better it is doing by that controlled maintenance standard. **However, when compared to the statewide average or other state agencies, it suggests that the Department's buildings are, annually, in greater need of controlled maintenance dollars than the average state building.**

Whether measured by facility condition index, current replacement value by gross square foot (CRV/GSF), or by the expenditure of controlled maintenance dollars, the data suggests that the Department's buildings are generally older and more deteriorated than those in other state agencies. Additionally, **staff is concerned that the relatively higher level of annual controlled maintenance spending for Department buildings** compared to the statewide average and compared to a department with 24-7 facilities like Corrections, **may be coming at a higher cost to the State over time, than the cost to renovate or replace the highest maintenance portion of the Department's building stock.**

**DHS Facilities Management Unit (DFM)**

The Department's facilities management unit, DFM, is responsible for all aspects of facilities management and is located in the Office of Administrative Solutions. DFM is funded, along with other administrative functions, through the Department's indirect cost allocation to divisions and programs.

In FY 2014-15, DFM had a total cost of $20.9 million and included 315 FTE. For comparison, the Capitol Complex – Facilities Management unit (Capitol Complex) in the Department of Personnel delivers similar facilities management services for Denver-Capitol area and other multi-agency buildings. Capitol Complex was budgeted $13.5 million and 55.2 FTE in FY 2014-15.

The OSA reports 3,818,063 GSF for DHS buildings and 1,684,300 GSF for Capitol Complex buildings. On this basis, DFM delivers facilities management services at $5.48 per square foot, while Capitol Complex delivers its facilities management services at $8.24 per square foot.

It is possible that DFM is providing a higher level of maintenance than average for state buildings as suggested by its higher controlled maintenance funding. Or it could mean that DFM is not doing a good enough job of maintaining buildings and so controlled maintenance needs are higher. However, based on the preceding analysis, it appears that DFM is likely servicing older and higher maintenance buildings and may be doing it at a lower cost than Capitol Complex.

**Interim OSA Controlled Maintenance Visits**

During the interim, staff visited several DHS campuses and other facilities, including Ft. Logan, Pueblo, and Grand Junction, with OSA staff during their controlled maintenance visits. These visits entailed meeting with facilities management staff – Department-level and campus-specific managers – and tours of specific controlled maintenance project needs and recently completed or in-process controlled maintenance projects. These tours almost entirely consisted of visual reviews of building systems, including roofs, windows and facades, elevators, heating, ventilation and air-conditioning (HVAC), electrical, and mechanical systems, and typically included walk-throughs of utility tunnels and mechanical rooms rather than general building tours of program services.

On these visits, staff was able to converse extensively with campus facilities managers about their work, resources, and Department support. Staff was generally impressed with both the awareness and knowledge of campus systems, including weaknesses and trouble spots, and with the level of attention paid to campus building systems by DHS campus facilities managers. Given the relatively aged and deteriorated condition of many of the Department's buildings and building systems, and what appears to be good work by DFM in overseeing facilities at the Department, regional, and campus or facility levels, staff was left to consider the effectiveness of the current, governing, budget, and Department management structure.

**The General Funded Model**

DFM can be described as a *cost-centered, indirect cost-funded model, serving General Funded program needs*. This is a traditional, government services model.

The *cost center* is an internal business service provider for the organization, with base costs paid to fund the program regardless of the level or quantity of services actually provided to end users within the organization. Theoretically, gradual adjustments would be made from year to year to increase or decrease funding for services based on historical usage. Practically, funding is determined through executive level decisions for apportioning available department resources.

In contrast, a *profit center* would sell its services directly to programs and divisions and earn revenue for its operations based on actual services provided. Its organizational growth or reduction is objectively tied to its revenue. A profit center is essentially a cash-funded program.

The *indirect cost* approach is "costed" or apportioned to programs or divisions through an indirect cost assessment. The Department's indirect cost assessment includes all other administrative "overhead" tasks and responsibilities that are handled for programs and divisions at the department level. Indirect cost methodology typically uses a proportional assessment based on FTE or personal services appropriations. It may also follow a federally-allowed,

defined percentage rate charged on every dollar of revenue collected from federal programs for administrative overhead that would be equally assessed on cash-funded programs.

The more difficult it is to identify discrete services or to price or collect a fee for such services, the more appropriate it is to use an indirect cost approach. So while indirect cost methodology is reasonable for apportioning human resources or accounting costs, it may not be a reasonable method to account for potentially significant differences in facility cost by program or division; especially when such costs can be discretely identified.

The weakness of an indirect cost approach is that there is not a clear cost signal provided to the end user for the cost of those services. Services appear to be "free". In the case of DFM, funding is entirely disconnected from a specific program's actual facility costs. In the case of DHS, the "end user" includes divisions and programs, executive managers, and legislative budget authorities. The actual facility costs for programs, particularly for facility-centric programs such as those located in specialized and dedicated 24-7 facilities, is vague and generally unknown and therefore the full cost of program expansion or the full savings from program reduction are also vague and unknown.

This varies from a *direct-cost* approach which would bill directly for actual services provided to programs or divisions. The disadvantage of a direct cost approach is the administrative cost of pricing, billing, collecting, and accounting for services provided. Based on conversations with DFM managers, it appears that DFM tracks all costs by facility that would be necessary for implementing a direct cost model.

The traditional, *General Funded model* relies on the relative availability of state funds. Even when there is a relative scarcity of state funds in a given year, the base budget assures that the operating budget will continue to be funded at a similar, base-adjusted level from the prior year. However, capital construction and controlled maintenance are not funded annually from a base budget. In this case, DFM and its personal services and operating expenses are funded on a stable basis from year to year, but capital construction and controlled maintenance for Department facilities are not necessarily funded consistently from year to year.

Additionally, DHS is a particularly program-intensive state agency, delivering a fairly complex spectrum of client care services. It is reasonable that such a program-intensive department will focus its energy on the need for additional resources for annual program operating needs first. That is not to suggest that facility needs are not requested by the Department. They are sought through the capital construction budget, and increasingly in recent years through the operating budget. They are usually a mix of very large – such as a Department-wide master plan, or facility replacement requests – and relatively small – controlled maintenance to keep current facilities updated just enough relative to life safety, security, and accreditation requirements.

But facility needs are generally not considered or built into program expansion plans and requests. Facility needs remain afterthoughts relative to constant, incremental program changes, until the point is reached that very large facility needs have to be addressed but money is only available for annual, "band-aid" maintenance projects. DHS program priorities do not include or

account for an incremental recognition of facility needs, because from the Department's perspective:

- To recognize and fully account for the cost of facilities might endanger a request for policy change and program expansion due to the additional, incremental cost for facilities.

- Facilities can always be addressed after the fact, when they are absolutely necessary for continued client, staff, and public safety and security.

- Facilities will necessarily be funded when it is made clear to budget authorities, through life safety and security failures, that additional moneys have to be spent on facilities.

And, consistent with a General Funded model, capital construction and controlled maintenance funding is regarded as generally outside of the Department's control – not something the Department can actively manage and therefore "be responsible for". The Department is entirely dependent and subject to the capriciousness of the economy and the General Assembly's annual decision-making. This approach leads to a lag in proactively planning for and improving or replacing deteriorated and unsuitable program facilities until the point of building failure; a general approach of "facility funding by crisis".

So, for DFM, controlled maintenance and capital construction funding is entirely reliant or dependent on the annual availability of state funds. Then, DFM is additionally dependent on the Department's policy priorities and its general, low-priority, low-effort, low-accountability, crisis-funding approach to facilities. DFM, as it is currently structured and funded in the Department's relatively large program structure is organizationally unable to proactively manage or guide Department facility needs. It is structurally bound to operate from a reactive position of "hoping" for funding for additional controlled maintenance and capital construction and it provides day-to-day maintenance to the extent possible with its operations funding.

This reactive stewardship of state resources along with higher-than-average annual spending on controlled maintenance that still provides only a bare minimum to keep facilities functional for ongoing program needs may ultimately come at a higher cost to the State over time. The inefficiency and waste is compounded by what appears to be an otherwise well-functioning facilities management organization that works efficiently with the resources it receives.

**Cash-funded Enterprise Model**

A cash-funded model – profit-centered and direct-cost funded – is the opposite of the indirect cost, General-Funded model. While the model requires the additional administrative tasks of pricing, billing, collecting, and accounting, a cash-funded model can price real property lifecycle costs and ongoing management services through lease payments and facilities management fees based on actual costs. Programs and divisions would have actual cost information to better understand the cost of their space. Executive and legislative decision makers can make better, more informed choices about program expansion and trade-offs between cost and quality of facilities.

The creation of an enterprise entity takes the cash-funded model one step further and provides facilities management outside of the Department and outside of direct state funding, potentially with access to bond financing authority. While a cash-funded enterprise can emulate industry property management practices, a state enterprise entity can be required to deliver these services at cost, preserving cost savings for the State that would otherwise accrue to profits in commercial leases.

**Real Property Asset Management**

Real property asset management is a process of decision-making and implementation regarding real property acquisition, use, and disposition assuring that a property is operated for optimum short-term and long-term performance, including fiscal sustainability and enhancement of value. Asset management can also be described as a systematic process of deploying, operating, maintaining, upgrading, and disposing of assets cost-effectively over every year of an asset's lifecycle. Asset management proactively matches real property management and property development with customer needs over defined and planned periods of time. Asset management objectively prices property lease payments and property management services to ensure financial sustainability through operating cash flow and reserves for real property lifecycle planning – acquisition, use, and disposition – that maximizes asset value for cost.

**A State Real Property Asset Management Trust and Finance Authority Enterprise**

Currently, DFM delivers property management services – day-to-day maintenance – but not asset management services. The current, DHS-DFM, General Funded model does not provide a governance or management performance incentive structure that is conducive to effective and efficient, short- and long-term, real property asset management. The Department of Human Services – as a program-intensive department – **should not be in the property management business.** The Department's entire effort should go toward management of its programs.

Facility management and property asset management should be provided as a direct cost business service to the Department. A cash-funded, enterprise model for real property asset management could provide a governing and management structure that incentivizes a customer-service approach to providing facilities and facility services for Department programs at cost while ensuring lifecycle financial sustainability and improved stewardship of the State's real property assets.

The creation of an asset management enterprise will entail the imposition of lease payments to be made by program or division for all Department facilities managed by the enterprise. This will increase the operating cost for programs by the cost of those lease payments. However, decision making for Department facilities by the Department, its programs, and budget authorities will be enhanced with clear and accurate cost information regarding options and levels of facility quality with a singly-purposed and fully-committed property asset management enterprise overseeing Department facilities.

Advantages include:

- A more business-based approach to asset management and stewardship of state resources.

- As facilities are developed and built within the enterprise management structure, the State's need to fund controlled maintenance for Department facilities will be reduced and possibly eventually eliminated.

- The elimination of the budgetary conflict about adequate funding for capital construction after operating expenses have been determined. Capital construction will receive its funding through the operating budget in the form of a lease payment that is equal to the annual lifecycle cost (including finance payment as necessary), annual operating expenses, and a capital reserve for controlled maintenance, capital renewal, and disposal.

The keys to the creation of a well-functioning asset management enterprise include:

- A well-defined governing board and structure that includes ongoing legislative oversight of property purchase decisions.

- Specified State policy goals regarding asset value maximization and cost minimization.

- Transparent reporting of measures of achievement through an annual asset management plan that includes measures of customer service and enterprise accountability.

- An organizational compensation structure that incentivizes meeting and exceeding annual, asset management (value generation and cost containment) and customer service goals. Compensation incentives should be designed to encourage efficient use of resources and prevent excessive organizational growth, service withholding, and other political forms of power expression that perpetuate the incentives of a traditional state program or agency.

**Recommendation**
**Staff recommends that the Committee pursue legislation to create a State Asset Management Trust enterprise to manage all Department of Human Services real property assets.**

Such legislation should include the following:

- The creation of an enterprise to function as a state asset management trust for Department of Human Services properties, effective upon passage.

- The establishment of an unpaid managing board, to be selected and organized by May 1, 2016, including membership requirements and responsibilities. Board members should include the chair of the Joint Budget Committee, the chair of the Capital Development Committee, the director of the Governor's Office of State Planning and Budgeting, the State Architect, and at least five non-government members with expertise in commercial real estate, public finance, commercial real estate finance, or real property capital asset management.

- The hiring of an executive director and administrative support staff by July 1, 2016;

- The provision for a General Fund loan for the enterprise's start-up costs, not to exceed operating expenses for the first 18 months, to be repaid over no more than five years.

- The development of preliminary asset management policies by November 1, 2016, that includes guidelines for the preparation and public release of an annual asset management plan for all capital assets managed by the enterprise;

- The development of an enterprise-wide compensation incentive structure by November 1, 2016, based on achieving defined customer satisfaction metrics and meeting long term fiscal sustainability through revenue, cost, and reserve targets set within the annual capital asset management plan.

- A preliminary budget recommendation by November 1, 2016, for leases to be paid by Department of Human Services programs to the enterprise beginning in FY 2017-18.

- The responsibility to establish leases and to begin collecting lease revenue from Department of Human Services programs beginning in FY 2017-18:
    - To provide for payment of ongoing operating costs of existing facilities, including custodial services and day-to-day maintenance;
    - To provide for payment of bond financing or lease-purchase payments for new facilities;
    - To provide for an adequate capital reserve or sinking fund for future controlled maintenance and capital renewal for enterprise-financed properties; and
    - To provide for the administrative costs of the enterprise.

- Recommendations to the Joint Budget Committee for additional legislation to codify in statute, as necessary:
    - Enterprise organizational needs, specifications, or requirements including finance authority;
    - Asset management policies;
    - Compensation incentive structures;
    - Business processes related to rights and responsibilities of the enterprise and its customers;
    - The transition to ownership of Department of Human Services properties;
    - Budget recommendations for the elimination of existing Department facility management appropriations and for the transition of Department facility management staff to the enterprise.

**Other DHS Property-specific Recommendations**

As previously stated, the Department **should not be in the property management business.** The Department should not act as a lessor for its buildings on the Grand Junction Regional

Center campus in an effort to preserve the campus and earn revenue on unused properties. Similarly, the Department should not act as a lessor for its otherwise vacant buildings at the Fort Logan campus.

Section 26-1-133.5, C.R.S., authorizes the Department to rent its surplus facilities on the campuses of the various institutions operated by the Department. The statute does not provide guidance regarding the recovery of the actual full cost of the property. It only requires that the "Department shall not enter into any lease agreement ... that is expected to result in a financial loss to the State."

The current property rental program at Fort Logan does not adequately price rents to recover the full cost of those buildings. Rather, the rental program only charges a nominal amount for the purpose of paying for maintenance projects for those buildings. Generally the surplus properties are leased to community non-profit organizations at a below-market rate. While the assistance provided to these programs from a below-market rent generates a social benefit, not recovering the full cost of the properties is a subsidy that is being provided by the State through this process.

If providing space for community programs at below-market rents is the public policy intention of this statute, then that goal should be clarified. Currently, the generation of any revenue that helps to pay for facility costs arguably meets the statutory requirement. Under current statute and Department practice, the Department is recovering less than the full lifecycle cost of these properties, and, in effect, subsidizing the facility cost for these programs. Keep in mind, without any additional statutory guidance, a real property asset manager charged with the responsibility for its own long term fiscal sustainability cannot lease a property for an amount less than the full lifecycle cost of that property.

**Grand Junction Regional Center Campus**

**Staff recommends that the entire Grand Junction Regional Center campus be sold,** regardless of policy and program decisions that may be made regarding the operation of a regional center in Grand Junction. If it is determined that there should be a regional center in operation in Grand Junction, then plans should be made for such a facility, just as group homes and related facilities are located in the community away from the campus. The historical property of campus buildings and utility infrastructure are overly expensive to actively maintain for a diminished client community. Any clients currently served in Grand Junction could be served at a lower cost in a more appropriate facility in the Grand Junction area. Ownership and maintenance of the campus absorbs excessive state resources that might otherwise be directed to improved or expanded client services or other needs.

It appears that the property – the campus as a decision point – may be "driving" or otherwise distracting the discussion from the necessary focus on the relevance of client and "program" needs apart from the existence of the campus. **Staff recommends that the Committee pursue legislation as necessary to sell the Grand Junction Regional Center campus as soon as possible.**